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Thoroughbred Racing--Getting Back on Track

Thomas H. Meeker
Churchill Downs, Inc.

Introduction

Thoroughbred Racing—Getting Back on Track

BY THOMAS H. MEEKER*

It has been over five years since I assumed the position of President and Chief Executive Officer of Churchill Downs. Prior to my arrival, I imagined Churchill Downs in terms of a bright spring day, mint juleps, 130,000 racing fans waiting to sing "My Old Kentucky Home" and the twin spires, the hallmark of the track. Those continue to be the images of the rich tradition of Churchill Downs, the home of the Kentucky Derby. However, I saw none of them when I arrived at Churchill on a hot day in July 1984.

A paltry crowd of about four thousand came that day to see races with as few as four horses running for a top purse of ten thousand dollars. The patrons gathered in a facility that was run-down and in need of substantial repairs. The track had experienced a net operating loss in 1983, and the downward trend was continuing in 1984. Due to the company's poor financial performance, dwindling attendance, and declining handle,[1] the cadre of employees who greeted the customers were more concerned about job security than customer service. The track had lost its position as an industry leader, and, aside from the Kentucky Derby, the future looked bleak for Churchill Downs.

I soon learned that what had happened at Churchill Downs had happened throughout the racing industry. Racing had found a low point in its history and that is how I was introduced to the

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* President, Churchill Downs, Inc. B.S. Northwestern University, 1965; J.D. University of Louisville, 1973.

[1] "Handle" is a term used to describe the total amount wagered on a race or races. It is synonymous with the term "sales" in the lottery industry.

sport. I never imagined that the racing industry was in such chaos, nor did I realize that the industry was on the threshold of positive and dramatic change. Now, after five years at the track, I have a clearer vision of Churchill Downs and the racing industry. The future looks brighter today, but significant challenges remain.

To understand where racing is today and where it is going in the future, it is helpful to trace how it reached its low point. There are a number of factors that played a role in racing's downturn, but the greatest contributor was the failure of the industry to aggressively respond to changes in the competitive environment.

Racing has been a part of the American culture from colonial times. The first American race was run on the plains of Hempstead, New York in 1668.[2] The British governor of New York, Colonel Richard Nichols, ordered that races be run at regular intervals so that the speed and stamina of the American horse could be improved. Racing grew as a sport, but racing also became very much a part of the legalized gaming industry. For years, racing held a monopolistic position in many states where gaming was authorized. Without any significant competition in most states, racing prospered through the years and grew to be one of America's leading pastimes.[3] By 1970, things began to change.

The 1970's presented several problems for the racing industry. Like any industry, a soft economy and high inflation threatened racing's bottom line. Construction had nearly ceased and track operators began to defer capital investment and maintenance expenditures until better times. Racetracks had become, or were fast becoming, dark and dingy tombs that were unattractive to both current customers and any potential new customers.

Also in the 1970's, new forms of competition began to appear. Casinos opened in Atlantic City threatening east coast racing. Cable television began offering expanded sports coverage, and state lotteries became more prevalent. In 1970, there were only two state lotteries (New Hampshire and New York) with combined sales of $49.2 million. By 1988, there were twenty-seven state lotteries with combined sales of $15.0 billion, a remarkable growth

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[2] MENKE, DOWN THE STRETCH, THE STORY OF COLONEL MATT J. WINN 19 (1944).

[3] Not until 1984 did baseball overtake racing as the sport with the highest annual attendance in the United States.

of 30,487%.[4] Since 1988, five more states, including Kentucky, have started lotteries and more are on the way.

Late in the 1970's and continuing into the 1980's, another phenomenon began to appear. Racing associations, under pressure from horsemen and state racing commissions, started to expand racing days.[5] This was done with the view towards increasing the handle thereby increasing state tax revenues and horsemen's purses.[6] The expansion of racing days did produce larger handles but the increases did not offset increased expenses incurred by the racetracks. For instance, in 1983 and 1984, Churchill Downs expanded from 79 racing days to 117. The company lost $3 million before returning to the traditional 79 day race program in 1985.

The expansion of racing days altered traditional racing circuits, creating a shortage of horses and intensifying competition for quality horses among racetracks conducting simultaneous meets. Changes in the breeding industry also contributed to the shortage of quality horses. In the early 1980's stud fees and yearling prices reached record levels as foreign investors, Arab interests in particular, entered the market. Owners moved champion horses from the racetrack to breeding farms where a successful stallion or mare could generate millions of dollars. The attraction of these breeding dollars cost the racing industry many of its stars, generally when the horses reached the age of four.

Aside from prestigious races such as the Kentucky Derby, the only way to compete for quality horses was to increase purses. With declines in handle at most racetracks, however, this was a significant challenge. The industry axiom "money makes the mare go round" was never more true than in the 1980's. Racetrack operators searched for ways to increase purses and found two sources: legislative relief and corporate sponsors.

With strong lobbying from racetrack operators and horsemen, legislatures across the country began reducing parimutuel taxes. For many tracks, these reductions provided the only means for survival. In Kentucky, Ellis Park and Turfway Park obtained a tax reduction from 4.75% to 1.50%.[7] In 1986, Kentucky's largest

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[4] LOTTERY FACTS, GAMING & WAGERING BUSINESS 20 (March 15, 1989).

[5] In 1970, there were 6,242 racing days in the U.S. By 1988, there were 8,488, an increase of 36%. THE AMERICAN RACING MANUAL 218 (1989).

[6] It is important to note that state taxes and horsemen's purses are computed as a percentage of handle, not as a percentage of admission, parking, concession, or program revenues that are directly tied to attendance.

[7] KY. REV. STAT. ANN. § 138.510 (Bobbs-Merril 1988).

racetracks, Churchill Downs and Keeneland, obtained a 1% tax reduction that was applied exclusively to purses.[8]

In the early 1980's, racing began to court corporations with a view towards selling race sponsorships. Several companies such as Budweiser, Phillip Morris (Marlboro), and Jim Beam became named sponsors of major races. The first one million dollar purse was offered in the Budweiser Million at Arlington Park Racecourse in 1981.[9] By 1988, there were fifteen races with purses of one million dollars or more and several million dollar bonuses paid for winning a series of races.[10] In 1987, Chrysler Motors became the sponsor of the Triple Crown Challenge, which guarantees the owner of a horse that wins the Kentucky Derby, the Preakness Stakes, and the Belmont Stakes a purse of five million dollars.

With the increase in purses and a decline in the sales prices of thoroughbreds, the lure of the breeding farm subsided and today we see such equine stars as Alysheba, Ferdinand, and Winning Colors competing on the racetrack after their three-year-old campaigns. However, the competition for quality horses remains one of the key problems for racetrack operators.

The rate of change within the racing industry accelerated during the mid-1980's and the entire industry continued to struggle to gain a foothold in the new competitive environment. Nowhere was this more evident than at Churchill Downs, where the new management team was confronted with myriad challenges.

When we arrived in August 1984, the track was about to end its second and final summer race meeting. The expansion of racing days had driven daily average attendance and handle to new lows. It was readily apparent that changes needed to be made and with some degree of urgency. The newly organized management team commenced the development of a business plan that would reposition the company in the industry and the community. The ultimate plan involved three simple strategies. First, the entire marketing program was to be restructured around the concept of developing Churchill Downs as a year-round entertainment facility. Second, a capital improvement program was to be developed that would allow the track to be competitive with other entertainment venues and also serve as an industry leader in racetrack

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[8] *Id.*

[9] Renamed Arlington International Racecourse in 1989.

[10] *See supra* note 5, at 78.

design. Third, and perhaps most important, a community relations program was to be developed that would improve the company's public image. Each of these strategies worked and continue to be the cornerstones of our business plan for the future.

The marketing program was developed in conjunction with the capital improvement program, and together they represented a true paradigmatic shift, a transformation in the way of thinking about our business. For years, Churchill Downs had been marketed as a racetrack that was the home of the Kentucky Derby. Capital improvements and marketing efforts were focused on the Derby and little attention was paid to other days of racing, other products that could be developed as revenue sources, or the potential of using the track during the off-season.

The marketing program first identified products within three general groupings—sports, gaming, and entertainment. Next, market demands where new products could be developed were identified, and, finally, delivery of quality customer service became a focus. This marketing program also dictated how capital expenditures were to be spent and where personnel resources were to be committed.

As we inventoried our array of products, it became clear that none were competitive. Our racing program, the showcase of the equine athlete, was suffering from short fields and a lack of quality horses. Purses had to be increased for the program to become competitive. With the help of a one percent reduction in the pari-mutuel tax and the addition of several corporate race sponsorships, purses increased and the racing program came alive. In 1984, the average daily purse distribution at Churchill Downs was $92,893. By 1988, the average daily purse distribution rose to $183,052. The addition of a three million dollar turf course also aided in the attraction of an assemblage of new horses. These efforts produced dramatic results reflected by the increased number of horses running in the races and the quality of the fields. As the purses drew larger and more competitive fields, the handle increased, which in turn created even more money for purses.

Our gaming products also had grown stale. With the advent of the lottery, the public's appetite for high payoffs intensified. Patrons became willing to risk more dollars to win larger payoffs. In response to this demand, new wagering combinations were introduced that would produce higher payoffs. These included: exactas (pick the first and second place finishers in order), the pick six (pick the first place finishers in six races) and the pick three (pick the first place finishers in three races). Again, the results were impressive. An example is the pick-six pool of $1,362,000 that occurred in 1987. For five days, there were no winning tickets on the pick-six pool and the pool was carried over to the following day. As the pool became larger, so did the attendance and handle. Finally, on Saturday, a crowd of 28,396 attended the races and wagered $3,382,557. There were three winners who received $396,958 each, the largest payoff in the history of the track. On a normal day our attendance would have been 16,507 and they would have wagered $2,195,030.

We also discovered that there was little entertainment opportunity provided at the track outside of pure gaming. There were no facilities or activities at the track that attracted anyone except the ardent horse-player. Consistent with the industry at large, our patrons had grown older and were predominantly male. We needed to attract a broader demographic mix. Under the capital improvement program, we endeavored to develop areas on the track that would satisfy the entertainment demands of the new demographic segments. A private turf club was built for corporate entertainment and for those patrons who wanted exclusivity. On the other hand, Silks, a bar with entertainment, was created for the younger people who wanted a casual setting during and after the races. In virtually every corner of the track, new facilities were added that created added comfort for our customers and that could be used by the track for off-season events.

Through an intense training program, the employees of the track came to realize that they were in the entertainment business and that the primary means of achieving a competitive edge was by delivering quality customer service. Each of the employees came to understand the relationship of customer service to the success of the company and their own job security. Today, our employees take great pride in their performance, appreciate the competitive challenges that confront our business, and are actively involved in the development of new ideas to improve the level of customer service.

The community relations program developed in 1984 was a critical element of the overall effort to reposition the company. For years, Churchill Downs had little contact with the community except during Derby week. Reestablishing community contact called for the involvement of the company and its employees in civic and charitable activities. It also involved the company's financial support of activities designed to improve the community's quality of life. Gradually, Churchill Downs became involved in all aspects of community affairs.

The community relations program produced better results than expected. Churchill Downs gained a reputation as a good corporate citizen. More important, community leaders and public officials came to accept the fact that the track is a vital asset for the community in terms of jobs and tourism. This positive image facilitated better relations with regulatory authorities, neighbors, and our patrons. Recently, city officials announced a plan calling for the redevelopment of the area surrounding the track. Such support would not have been possible five years ago.

As a postscript, the revitalization of Churchill Downs has been mirrored, more or less, throughout the entire racing industry. Tracks like Ellis Park, Turfway Park, River Downs, Garden State Park, and Arlington International Racecourse have completed extensive capital improvement programs. Recently, Arlington International Racecourse reopened in Chicago after a disastrous fire in 1985. A facility costing in excess of $120 million has replaced the old clubhouse and grandstand. Arlington's emphasis on customer service is perhaps the strongest in the country, and this is reflected in their attendance and handle.

Now, let us look at the future of the racing industry in a growing and increasingly competitive environment. There is no question that the racing industry is on much sounder footing than it was ten years ago. However, racing is still not keeping pace with its competitors in the gaming industry. Between 1982 and 1988, legal and illegal wagering grew 67%,[11] better than the growth in personal income, which increased by only 52.1%.[12] Yet, parimutuel wagering on horse racing increased only 14%. Racing is continuing to lose market share in the growing gaming industry.

What can racing do to compete more effectively in the future? While not exhaustive, three strategies deserve consideration. First, the racing industry must adopt an aggressive marketing strategy that, at a minimum, identifies changes in market demand as quickly as possible. The industry also must make better use of its operating assets. Perhaps racetracks should be designed as mul-

[11] CHRISTIANSEN, 1988 U.S. GROSS ANNUAL WAGER, GAMING & WAGERING BUSINESS, 18, 21 (July 15, 1989).

[12] United States Department of Commerce Bureau of Economic Analysis, Survey of Current Business, vols. 66, 67 and 68, nos. 3 and vol. 69, no. 2 (March 1986, 1987, and 1988, and February 1989).

tiple use facilities so that during the off-season a return can be obtained from otherwise dormant assets. The marketing strategy must also focus on the entertainment value associated with attending races. Finally, entertainment opportunities must be made available to a broad demographic base.

On an individual basis, track operators must adopt a time-based marketing strategy. Time-based competition is a growing practice among successful companies and requires the capability to introduce new products more quickly and be more responsive to market demands than a competitor. This strategy is based in part on the traditional profit impact of market strategy (PIMS) theory. This theory maintains that the first to the market with a new product will obtain 50% of the market. The second to the market will get 25%. The third will obtain 12.5% and so forth.[13] A company adopting this strategy must be willing to accept the fact that change will be constant as new products are developed to meet changing market demands.

Lotteries are good examples of time-based competitors. Lotteries are constantly testing the market place for market demands and introducing new products to meet those demands. For instance, the Oregon lottery recently introduced a sports betting game based on the results of National Football League games. The Kentucky lottery quickly attempted to follow suit, but was stopped by the intervention of Governor Wallace Wilkinson. Racing, on the other hand, has generally responded, not to market demands, but to the actions of its competitors, most often the lotteries. For instance, the introduction of new wagering combinations did not occur until racing was faced with the large prizes offered by lotteries.

A second strategy for racing in the future is to expand the distribution system for its gaming products. It is hard to believe that the racing industry can compete with the lotteries, which have a distribution system involving thousands of agents, by selling its gaming products from a single location. This inherent advantage of the lotteries is, in most states, preserved by statutes prohibiting wagering at off-track locations.

Recently, the industry has been experimenting with various forms of simulcasting as a means to expand the distribution system. Simulcasting involves sending a television signal of a live

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[13] For a detailed discussion of time-based competition, see S. DAVIS, FUTURE PERFECT (1988).

race from the running track to another location within or without a state. Variations on the simulcasting theme include intertrack wagering (ITW),[14] off-track betting (OTB),[15] and telephone account betting (TAB).[16]

Care must be taken by racetracks before implementing any of these systems. This is particularly true if a system is allowed to operate in an existing racing market. If located within an existing market, an alternative wagering site operates as competition for the on-track race patron and, as such, on-track revenues are threatened. The increase in handle from the alternative wagering sites may or may not offset the loss in on-track, non-parimutuel revenues associated with admissions, concessions, parking, and programs.

ITW is a strategy that assumes that a greater penetration can be made in an existing racing market by giving the patron more access to wagering. In Kentucky and in other states operating in this configuration, ITW has produced aggregate handle increases, but at the expense of significant declines in on-track attendance.[17] Accordingly, track operators have been less impressed with the results of ITW than state racing commissions and horsemen who reap the benefit of the increases in handle.

The long-term effect of a reduction in on-track attendance is of great concern to many people in the industry. The sport of live racing, with its color, pageantry, and excitement, is racing's primary and distinguishing product. This product is not available through the purchase of a lottery ticket at a gas station or a mutuel ticket at an alternative wagering site. If racing becomes a pure gaming operation centered on an ITW, OTB, or TAB system, it is likely that several tracks will cease live racing. The expenses of running a live race meeting can be avoided by simply

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[14] ITW is a configuration where the receiver of the signal is another racetrack that may or may not be conducting racing operations. If the operations are intrastate, all the wagers made on the receiving track are combined with the sending track's pool. In an interstate configuration, the receiving track operates a separate pool and separate payoffs are calculated.

[15] OTB is a configuration where the receiver of the signal is simply a betting shop. This system was first instituted in the state of New York in 1971. Today, there are several states that authorize OTB operations.

[16] TAB is a configuration where a person can wager by telephone using money previously deposited on account with the track. Generally, it also involves delivery of a television signal of the live race.

[17] For an analysis of the effects of ITW in New Jersey, see R. THALHEIMER, AN ANALYSIS OF INTRA-STATE INTERTRACK WAGERING IN NEW JERSEY—A CASE STUDY (October 16, 1989) (unpublished, University of Louisville Equine Industry Program).

importing a simulcast signal from an operating track. Today, several smaller tracks throughout the country are employing this tactic to fill out live racing programs. If this trend continues, the need for horses will be reduced, jobs associated with the caring and training of these horses will be lost, the breeding industry's market will be eroded, and the very character of the sport will be altered. Horses could become nothing more than roulette balls, the means of determining the winner of a wager.

Of the systems currently under consideration, OTB and TAB, properly configured to protect existing racing operations, appear to have the greatest potential for growth in the industry's market. These systems allow a racetrack to expand its operations into new markets where racing does not exist. Conversely, ITW seeks to expand an existing racing market much like we saw with the attempt to expand racing days. Generally, the expansion of racing days hurt the racetracks.

Racetracks have learned one valuable lesson over the years. Any alternative wagering system must be controlled by the racetracks. New York's attempt is regarded as an example of how not to do it. In New York, a mature, statewide OTB system is in existence. The system is operated by various governmental bodies, not the racetracks. The result has been that OTB shops are located on the doorsteps of most racetracks in the state. A more enlightened approach may be found in Illinois, where the racetracks control the OTB operations.[18]

A third strategy meriting consideration is the establishment of a national organization responsible for coordinating racing activities throughout the country. Today, each state, through a racing commission, controls the assignment of racing dates and regulates all of the activities of racetracks within the jurisdiction. Unlike other professional sports, there is no commissioner who schedules games, negotiates with players, and generally supervises the overall activities of the league. Absent this kind of central coordination, racetracks will not be able to create racing circuits reducing the shortage of quality racing stock, to maintain a uniform security program directed at maintaining the integrity of the sport, and to develop a national recognition of our sport through advertising and public relations. The time has come for racing to collectively market its products as an entity, much like Major

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[18] ILL. REV. STAT. ch. 8, ¶ 37-28(h) (1988).

League Baseball, the National Football League, and the National Basketball Association. There are a number of national organizations that attempt to perform some of these functions but, to date, none has been successful in exercising control over the entire industry. Given the politics involved among the members of the industry, such a goal may be impossible to achieve.

The changes I have witnessed since joining the racing industry have been impressive and have substantially improved our sport. Today, we see a sport that is characterized by aggressive management, innovative marketing, increased television exposure, and significant capital infusion. The question for the future will be whether racing will be able to capitalize on these assets and react to changes in the competitive marketplace in an aggressive, risk-taking, and more timely manner than it has in the past. That certainly is the intent of the management of Churchill Downs.