

The Economics of Joining Forces with a Coin-Operator

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This article is based upon both companies' experience, as they represent both sides of the table in the FEC-owner and coin-operator relationships.

For the same reason that folks don't pay \$7 apiece for a movie just because they crave a big tub of popcorn, they also don't usually head for the family entertainment center (FEC) just for the games. It's the anchor attractions — the movie, or in the case of the FEC, the rides, go-karts or miniature golf, etc. — that draw customers. Does that mean the games are unimportant? Absolutely not. Gross game revenue typically represents between 20 percent and 40 percent of total FEC revenue, and games account for 10 percent or more of the cost of developing an FEC.

FEC owners have a choice between owning and maintaining the games themselves or linking up with a qualified coin-machine operator. Unfortunately, many FEC owners make the decision whether to enter into a revenue-split alliance with a coin-operator based on bad or incomplete information, which can cost them plenty.

In little over five years, FECs have gained significant market share within the location-based entertainment industry. While there's no formal census of the current number of FECs, estimates in the U.S. range into the thousands, and new FECs are being developed at a rapid pace and are appearing on every continent in the world.

FECs include outdoor-oriented family fun parks with miniature golf, go-karts, bating cages, bumper boats, other attractions and clubhouses with food and games. They also include indoor FECs ranging from 10,000 sq. ft children's pay-for-play centers anchored with soft modular play equipment, to 100,000+ sq. ft. mega FECs. Games, including stand-up and ride simulation videos, redemption, novelty, pinball and kiddie rides, are an important part of the equation.

So what determines whether games will be profitable? There are four components to the economic equation of operating games in an FEC:

- the FEC's attendance and potential per capita game revenue
- the capital (\$) required to buy the games, both the original ones and the continual new replacements
- repair, maintenance and upgrades
- the knowledge of game selection, set up and operations

If the games belong to the FEC, the FEC owner inherits the headaches and revenue from all four elements. When the FEC contracts with a qualified coin-operator, the FEC owner has few of the headaches and at least half of the revenue from the games, along with some important non-monetary benefits.

It's the movies, not the popcorn

If you're a popcorn lover, you'll probably avoid a movie theater with a stale, badly flavored product. Similarly, if you're really into games, and the game selection at an FEC is poor or the machines are broken down, you'll go to another FEC. But few people place that much importance in popcorn or games. Most show up because of the anchor attractions — rides, soft modular play, laser tag, miniature golf, and go-karts — and the games are impulse purchases, like food and drinks. Along with the anchors, guests also visit because of group business like birthday parties, camps, corporate parties, graduations, lock-ins, etc.

To continue with the movie analogy, even the best popcorn probably won't tempt a customer to choke down another super-gigantic tub. With games, the number of games does not affect game sales so long as there is an adequate number, appropriate mix and quality. Once you have that, it makes no sense to, say, double the number of games because it won't make any more money.

You see, the games are just sitting there waiting for the anchors to pull in the crowds, because attendance determines the potential game revenue. Game revenue is figured per capita, as the average amount that a guest will spend on games each

visit, and is typically \$2 to \$4 per capita, or more in large FECs. What will make a difference is if you have the latest, hottest games, which will keep gross per capita game revenue at its highest potential revenue and give the guest an excellent experience.

An FEC that goes with a qualified coin-operator to supply games won't see an initial jump in attendance, but will see a jump in per capita game revenues, especially if the previous games were not current. It's the FEC owner's job to pull in the guests by topnotch anchors, marketing and operations. Once they're there, however, it's the coin-operator's job to capture the per capita game revenue by supplying the games and the expertise and maintenance. And the longer the customers stay to play games, the more they will spend on food, drinks and other attractions.

Is the coin bank half full or half empty?

The typical first response from an FEC owner approached by a coin-operator is, "Why should I give you half my games' revenue?" The savvy coin-operator will reply, "Because I can make your investment in your FEC more profitable." The open-minded FEC owner will then take the time to look at the whole financial equation, which includes these contributions by the coin-operator:

- supplying the capital to pay for the games, thus reducing the FEC's cost, borrowing and loan payments, and the owner's and investor's required equity capital
- paying for all the repair parts
- paying for half the cost of prizes, tickets, tokens, licenses, etc.
- contribution to the cost of labor to maintain the games
- supplying the capital to buy new games and remove non-revenue producing games
- providing superior knowledge of game operation and management, resulting in higher per game revenue and more per capita spending
- freeing the FEC's management from game maintenance and management, allowing them to focus on the core business of delighting their guests
- improving the FEC's return on owner equity (capital), the only real measure of an investment's profitability

Let's take a visit to the real world

These benefits are real, not just theoretical. The authors have analyzed the results of using or not using a coin-operator in a 15,000 sq. ft. indoor FEC. So long as the model represents an FEC that's reasonably well-designed and well-operated, the return on capital is higher with a coin-operator even if individual assumptions change. (Similar results were found no matter what the FEC's size or type.)

A warning: The numbers in this model are intended to be used only to illustrate the differences between FEC-owned games versus coin-operator supplied games. While the numbers are realistic, they are a generic composite of successful FECs and should not be used for purposes of projecting the financial feasibility of an FEC. Every FEC is unique, and its cost and performance vary significantly from the example depending on the market area, competition, location, mix, quality of finish and theming, and a host of other variables. These numbers do not replace a market and feasibility study and advice on mix and design from professional FEC experts. In other words, if these numbers show up in your financial projections, we will be very, very disappointed.

Figure #1 is the assumption table. Figure #2 shows the annual revenue, expenses, and return on investment (both cash and after tax) under three different scenarios:

Column A: all the games are owned and maintained by the FEC

Column B, C & D: the games are supplied by the coin-operator

Column B: there is no increase in per game or overall game revenue. (This is rarely if ever the case; the example is

included to illustrate the economic outcome even under this scenario.)

Column C: the coin-operator achieves a 25 percent increase in game revenue, but no change in the FEC's other revenue.

Column D: the coin-operator achieves a 50 percent per capita increase over when the games were owned by the FEC, and increases the FEC's attendance and resultant sales by 5 percent through superior operations.

Columns C and D illustrate the real world experience both authors have had when an existing Fec changes in mid-stream and contracts with a coin-operator to take over the games. This mid-stream switch happens when the Fec owner realizes that he or she does not have the experience, expertise and focus to manage the games to the FEC's full potential. In most situations, the Fec owner's games management is so poor that it has not only hurt the game revenue but also the Fec's reputation, attendance, and sales. This is like having popcorn that is so burnt or stale or greasy that people avoid the theater. (It is my opinion that any FEC that does not average more than \$200 per week per game for all its redemption games should seek help in some way from an experienced coin-machine operator well-versed in redemption operations. Chairman)

Even with no change in game revenue (Column B), the FEC is economically better off using a game coin-operator. Both the FEC owner's cash flow and return on invested capital is higher (also Figure 3 and 4). And in the more realistic scenario of a qualified coin-operator achieving higher per game revenue, the FEC owner really benefits. Cash flow is even higher, 29 percent higher with game revenues up 50 percent (Column D), and cash-on-cash returns increasing almost 50 percent to a 23 percent after tax cash return on invested equity versus only 16 percent if the games are owned by the FEC. It sure is hard to argue with an FEC that costs less, requires less equity capital, and generates more money for the owner and a higher return on investment.

Benefits money can't buy

So, far we've focused on the monetary benefits of working with a qualified coin-operator. Some of the services that coin-operators provide to FEC owners aren't obvious from a dollars-and-cents chart. Here are some taken from a list developed by Alpha-Omega Amusements of 50 ways a coin-operator can benefit an FEC. The coin-operator can:

- keep the owner informed on coin machine industry trends
- rotate game sin and out, including the newest and hottest games,, each month or more frequently to keep the mix fresh and appealing
- constantly upgrade existing games to improve the games' operation, reduce down time, and increase revenues
- recommend new attractions for the FEC
- share information on marketing and operations that the coin-operator learns from other FEC clients
- set the ticket payouts (hit ratio and percent) for each redemption game properly to balance the entertainment value with the payout
- layout the games in an attractive and inviting manner
- keep changing the game layout to give the FEC a new look
- help market the FEC to bring in more customers'
- organize tournament and contests to promote the FEC
- train the FEC staff to make minor game repairs, load tickets, unjam coins, put the right balls back in the right games, and clean the outside portion of the games well
- make redemption prize recommendations and help find discounts for the FEC from major merchandise suppliers
- get faster response time on game repair and replacement parts

- improve traffic flow and way-finding in the entire FEC

The owner of an FEC already has enough to worry about without adding the games to the equation. By contracting with a qualified coin-operator, an FEC owner can concentrate on the anchors — the attractions that pull in the guests — and on serving the guests when they arrive. That way the games, the impulse purchase, are the responsibility of an expert who can squeeze every bit of potential profitability from them.