AMERICAN RACING’S SUSTAINABLE FUTURE

There are reasons to be optimistic about the future of Thoroughbred horse racing in America.

Among those reasons, the greater industry has floundered for roughly the last two decades without meaningfully trying to improve itself. Imagine the possibilities if we try! The pessimistic view is much easier to relate.

Horse racing has experienced sharp declines in participation via wagering which is down approximately 50% in 15 years adjusted for inflation. Tracks have closed, attendance has dwindled and the foal crop is at sixty-year lows.

Quite remarkably, though, it has not seemed to matter much to present-day owners or breeders. Field sizes are low and prize money is superb, heavily subsidized in most jurisdictions by other forms of gambling. If you are racing horses in 2020 America, the state of racing appears quite strong.

But what if those purse contributions from alternative sources of gambling went away – slowly or all at once, a process known as decoupling? There is every reason to think that is going to happen in some American racing jurisdictions over a staggered period of time. Left to fund itself, racing faces a far more uncertain future.

Combine this financial threat with these other considerations:

- racing’s public perception issues and the tenuous nature of its social license to operate,
- the growing distant connection between people and horses,
- the expansion of legal sports betting.

Racing must commence a dramatic campaign to modernize and evolve. Doing so will retain more jobs and participation within the industry, particularly beyond the industry’s strongest market of Kentucky. Failing to change will yield greater contraction in every segment of the market and the hardship that comes with it. Change must come from within.

In this fairly brief paper, we identify three major systemic issues that are stunting racing’s evolution and offer a call to action to develop American racing’s sustainable future. Our later recommendations are broad, and unquestionably, difficult to execute. The industry’s long-term record on adopting transformational change is practically non-existent.

Racing sits at a critical juncture, seeking to find common ground on many issues where differences currently exist, but needing stakeholders to be open to bold actions required to modernize the industry, meeting and adapting to current market realities. The actions outlined in this paper seek to better secure the future for everyone in the sport, no matter where you stand on “the federal bill,” crop use or other divisive topics.

If American racing wants a more sustainable future, we must evolve.

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RACING'S THREE SYSTEMIC ISSUES

Issue 1: State racing commissions, established as the regulatory bodies for the sport, are replete with political appointees, most of whom do not value standardized rules across states or the need to improve the transparency and competitiveness of the sport.

American racing suffers from a decentralized oversight structure. Racing is enabled and overseen by the states. Some states choose not to allow racing or wagering for a variety of reasons. Those that do appoint citizens of the state to serve as commissioners of the sport, often by order of that state's governor.

In a 2001 column entitled "The Shame of Boxing," reporter Jack Newfield, who proclaimed boxing as his "guilty pleasure," outlined that sport's struggles.

"…politicized passivity is what has allowed boxing to evolve its strange economic structure that is half monopoly and half piracy. Boxing is like no other sport. It has no national commissioner to set standards for health and safety. In boxing there are no leagues or schedules. Every match is a separate deal. There is no rational structure. The chaos itself becomes an impediment to reform. The casual fan does not understand how the sport is run."

As described above, Newfield may have been off on one point: boxing IS like at least one other sport – horse racing.

Racing's attempt to improve the work of commissions is not without effort. Many state racing commissions are represented within the Association of Racing Commissioners International (ARCI), whose Model Rules Committee has attempted to offer a standard set of rules across the sport for decades.

"Relying upon the collective expertise of regulatory personnel in member jurisdictions in consultation with regulated entities, industry stakeholders, fans and individuals, ARCI committees consider ways to improve and enhance the regulation of racing.

"The Model Rules are all encompassing… Regulatory entities are encouraged to adopt the Model Rules by reference as a way to enhance uniformity of regulation in a sport that has evolved to be multi-jurisdictional."

That sounds ideal, but yet rules still vary widely from state to state and many have not adopted the model set by an entity the state commissions have a hand in crafting.

What makes this even more frustrating is that many commissions approve almost every measure before them.

In Ohio, every single motion for at least its last 32 meetings, from January 2017 through November 2019, passed without a single dissenting vote. In Oklahoma, just one dissent was recorded from votes over its last 17 meetings as of November 2019. Maryland emerged from 2019 with just a single dissent across 10 meetings.

If state commissions have a habit of approving nearly everything in front of them, what would be the legitimate rationale for failing to embrace uniform rules of racing when many of the commissions participate in a central body designed to standardize rules? It defies logic, but so does much of the administration of racing.

Adding to commission-level struggles are routine budgetary constraints – from highprofile racing states to fringe players. Even as commissioner terms cycle, new members are often asked to jump-in without any orientation or formal onboarding process. Commissioner training is practically non-existent.

And yet, we seek evolution.

The individual commissions, on their own, have little interest or see little direct benefit to themselves, to improve the greater sport. Their collective inactions serve as examples of this. While not necessarily unmotivated, they lack incentives. It is not the fault of any particular group, state, commissioner or other individual, it is just how things have evolved. Many racing stakeholders suffer under this malaise, and unfortunately, commissions aren't alone in lacking incentives.

Issue 2: Most American racetracks are owned by entities which also operate casinos or additional gaming on-site, and are currently required to share revenue with racing.

For many of these tracks, horse racing is a secondary business at best, but more likely, a mere formality in order to continue operating additional gaming.

Between Churchill Downs Incorporated (7) and Penn National Gaming (11), these two gaming behemoths own at least a portion, or operate, 18 facilities which conduct live horse racing. The vast majority of tracks across North America have some form of non-racing wagering on their premises, or a nearby facility, and if not, may still benefit from a related agreement which provides subsidies towards purses. This trend has grown over roughly the last 20 years.

In states like Indiana, Louisiana, New Mexico, Pennsylvania and West Virginia, prize money at every track has been supplemented by revenue from non-racing wagering for much of that period.

In Pennsylvania, 88% of racing prize money earned in 2018 came from a revenue share of slot machines. In Ohio, where all seven of the state's tracks are owned by major gaming corporations, average prize money per thoroughbred race increased 201% from an inflation-adjusted $6,831 in 2010 to $20,612 in 2018.

As America approaches "peak" gaming, and particularly in certain regions in the country – with some combination of slots, table games and sports betting – we anticipate gaming corporations will seek decoupling of racing and casino licenses. That is, encouraging states to reduce or eliminate the requirements of such entities to continue running racing as a condition to operating their additional gaming outlets.

Decoupling is already a reality in greyhound racing, with Florida passing a constitutional amendment to ban the sport while enabling track operators to retain their slots licenses. Churchill Downs Incorporated is seeking the same opportunity in south Florida, eliminating racing at Calder (Gulfstream Park West) and shifting their pari-mutuel license to jai-alai. A judicial decision in 2019 will allow them this shift at the conclusion of an agreement with The Stronach Group, which has operated Gulfstream West, at the end of their 2020 meet.

Decoupling is coming to greyhound racing in Arkansas in 2022, joining a host of other states to permanently sunset that sport.

There is no reason to think the movement to eliminate horse racing won't gain momentum in the coming years. With ownership of such tracks already concentrated in the hands of major gaming corporations which benefit from casino licenses, the very operators of racing lack much incentive to maintain the sport provided they can continue their alternate wagering businesses.

Issue 3: Racing's own self-created organizations have failed to adequately address these many concerns and often downplay the role of wagering despite that being the most sustainable source of revenue in the future.

Wagering is the lifeblood of racing. Absent revenue shares from slots, special peel offs from taxes (a new purse enhancement for Texas tracks), or other ancillary sources, a sustainable racing future is grounded in a competitive wagering product.

Wagering on racing has declined an astounding 50%, adjusted for inflation, since 2003 and yet little has been done to arrest this decline. The reasoning for such inaction, however, has been obvious – prize money remains at record levels thanks to sources beyond racing.

The negative trickle-down of American racing without, or potentially slow reductions of, revenue from external sources is obvious. While the industry thrives in its natural home in Kentucky, a withering of the sport's vitality in more far-flung destinations will impact every corner of the sport.

Years of wrangling over topics such as Lasix and federal oversight have distracted from focusing on racing's operational basics – a competitive wagering product, significantly improved measures of transparency, and others. While the industry's own organizations are quite attentive to the need to make racing as safe as possible and years of reform have significantly improved aftercare options, both laudable accomplishments, prolonged ignorance of the sport's long-term financial sustainability is a monumental concern.

Owners' groups like TOBA, horsemen's organizations like the THA and HBPA, and national outlets such as The Jockey Club, the NTRA and even Keeneland should refine the scope of their missions and determine how they can more effectively work together to ensure that all of the issues facing racing are addressed in an effective and efficient manner.

The lack of a national voice for the sport – let alone a proactive campaign to promote horses, horse ownership and racing in the face of relentless external criticism from 2019 – is remarkable, but symptomatic. Change is required.

RECOMMENDATIONS

The stakeholder group with the greatest incentive to reform racing are horse owners. Commissions have generally shown a lack of interest to rehabilitate racing, instead sticking to regulating within their own rules while tracks have less expensive, more profitable casino operations driving their actions. As the financial driver behind getting horses to the races, horse owners should be stepping forward to plot a more sustainable course for the future.

How can we do it?

1. **Demand a reorganization of the industry's self-created groups.**

Missions and boards overlap. Racing's shaky status and gloomy future have emerged under this existing structure.

That's clearly not working.

We recommend adopting a three-tiered structure that would reorganize groups like TOBA, NTRA, ROAP, including elements of the work of the THA and HBPA, as well as The Jockey Club, and introduce centralization in various areas where it does not exist but is not otherwise prohibited.

Organization 1 would handle: Integrity, safety and welfare, registration, aftercare, and the pursuit of rules and regulatory uniformity, including medication policies.

Organization 2 would handle: Marketing, sponsorships, public affairs, owners' relations, crisis management, community service, outreach and education.

Organization 3 would handle: Wagering, technology, race planning and scheduling, as well as regular, centralized industry performance (metrics) reporting.

A concerted effort to take this centralization of many functions and work to establish a racing state compact, which recognizes the important role of state independence to regulate the sport at a local level, is a more realistic path ahead, even while fully cognizant that industry organizations, on their own, do not have the ability to regulate the sport directly.

Achieving this undoubtedly requires major cooperation with commissions and tracks, too. A stronger industry self-management is a crucial component to meaningful reform.

2. **Prepare to purchase or lease racing operations from existing gaming corporations.**

The racing industry's future is best in the hands of those who have the incentive to improve it. That is not our present-day reality.

Currently, racing is healthiest at tracks such as Churchill Downs, Del Mar, Keeneland, Oaklawn and Saratoga. The owners of these specific facilities do have incentives to succeed, rooted in their local communities' support and economic drivers tied to racing. In many other locations, that is far from the case.

Stakeholders should prepare for a future where existing operators of racing prepare to abandon the sport as decoupling spreads. The best path forward is to begin organizing groups to pursue purchasing or leasing racing operations from existing owners, where possible.

While the future of the sport is not in doubt in racing centers like Kentucky, the threat of contraction in other jurisdictions due to decoupling is severe. Horse owners have stepped forward before, and if racing is to continue with widespread participation, it will require significant investment.

Horsemen purchased $8 million in stock from an initial offering to keep Canterbury Park afloat in 1995. While stock ownership has concentrated over the years, market capitalization exceeds $57 million, the company has been profitable in 22 of its last 23 years through its 2018 results and is embarking on a $400 million development campaign to diversify its property, all centered around the racetrack. Off the back of years of success, Canterbury is now moving to link community development and racing.

If racing returns to being reliant on wagering as a primary source of funding for prize money, new operators will need to embrace competitive business practices for wagering, something which has generally eluded the sport during the last two decades where funding came primarily from non-wagering sources.

High takeout, high data costs, antiquated technology and a general disdain for wagering customers must be eliminated. If horse owners want to keep the sport going, it will need to present horseplayers and modern bettors with a respectable product.

3. Pursue market expansion.

The eighth most populous state in America does not host racing, nor is pari-mutuel wagering legal there yet, but a group seeking to bring racing to the state is gaining serious traction.

The Georgia Horse Racing Coalition, working with other interested parties, is aiming to construct a multi-purpose entertainment destination in suburban Atlanta, host racing eventually for about 60 days a year, potentially bid for the Breeders' Cup and capture the racing and breeding revenue which currently flows through their state but only on a passthrough basis.

There should be a note of caution. The plans of the Georgia Horse Racing Coalition included the addition of historical horse racing machines – essentially, pari-mutuel driven slots. Some elements of the greater expansion of gambling in Georgia want full-fledged casinos.

Without careful planning and execution, such a development could land this project in the same straits of other racinos in the late 1990s and early 2000s. That said, the whole scale vision as outlined by the GHRC appears far more holistic than the more widespread racino mess infecting many jurisdictions today.

An entertainment complex centered around horse racing is a far cry from the threats that face the sport in other corners.

Some states still have yet to approve ADWs and/or pari-mutuel wagering and simulcasting. How is the greater sport not seeking to expand its wagering customer base, particularly on the back of expanded wagering nationwide? Pursuing greater market expansion should be a priority, a task that could fall under a new centralized organization as outlined in our first recommendation.

SUSTAINING RACING FOR THE FUTURE

This paper does not outline every item needed to overhaul this industry; many are not touched directly and we recognize that.

Attempts to reorganize racing should be made, cognizant of the failures of recent decades with one exception – prize money. What has been great for many owners is far from guaranteed to remain that way. Insight that goes beyond the next condition book or stakes schedule is needed.

As referenced, our industry is at a junction. We must be open to bold actions to modernize, meeting today's realities.

The actions outlined above seek to better secure a better racing future for all stakeholders, no matter your views on the many issues that have divided us for some time.

In the coming weeks, we will add to this paper with a series of follow-ups to shed more light on our systemic issues and our exciting opportunity to improve.

It is time to better position racing in the 21st century. Reorganizing, investing and pursuing market expansion opportunities can yield a positive future for the sport in the hands of those who care most for its sustainable future.

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