

## **Code Allocation Model Consultation Paper #2**

**May 14<sup>th</sup> 2014**

The following paper presents the identified principles being considered when assessing changes to the code allocation model. These principles have been developed in conjunction with industry feedback from the March industry forums. It also presents a number of examples for a code allocation model for comment.

The principles are summarised in bullet form throughout the text.

### **Principles**

#### ***Supporting Sustainability***

For the Tasmanian racing industry the issue of sustainability remains of foremost concern. With current funding levels continuing to leave Tasracing with an operating deficit, growth in total code allocations is limited to CPI growth (in line with the funding deed). Tasracing continues to pursue further funding, commercial revenue growth or cost reductions to provide a viable base for long term sustainability.

This has a number of implications for code allocations beyond the historical increases. Firstly it limits the options for the sharing of revenue growth from racefield fees (RFFs) with codes in the short to medium term. Providing the codes with incentives based on the growth of RFFs is an attractive option for the future but not currently possible in the existing financial situation. Tasracing is taking significant actions to improve RFF revenues through pricing and definitions. A sustainable business model should allow industry to share in commercial success and this remains a key ideal Tasracing is working towards.

Secondly, Tasracing may take action to improve RFF income which may influence code specific performance measures. These actions are undertaken to improve the long term viability of the industry as a whole, with code specific implications being a secondary consideration. Tasracing is developing a comprehensive marketing plan which will focus more specifically on the growth of RFF income from all three codes. This is likely to result in an increase in promotional activity that is aligned with commercial growth strategies. Similar to RFFs above, including a measure of promotional spend within the code allocation methodology is highly attractive though not considered practical in the current situation.

- Affordability for Tasracing
- Promotes sustainability for participants
- Holistic view of the industry

### ***Funding Stability***

It is generally desired among participants that no code should have their funding decrease from one year to the next.

Code funding certainty and stability is considered important in that it provides confidence for participants and encourages longer term financial commitments in the areas of ownership, training facilities, breeding stock and other items. A reduction in code funding (usually resulting in stakes reductions) or even the *potential* for reduced funding could seriously impact code specific confidence leading to sharp declines in activity and investment within the code.

An extension of this principle is that each code should see at least some increase on an annual basis. Such a guarantee (with the sustainability caveat) adds further confidence for participants.

- Reliable and consistent funding and product
- Participant confidence

### ***Recognising Economic Impact***

While revenue generation is a critical consideration for all racing decisions it needs to be recognised that the industry receives approximately \$29M per annum from the State government. The government's return from this investment is the economic, employment and social activity the racing industry generates.

The recently completed Size and Scope Review of the Tasmanian Racing industry highlighted the economic value of racing to the Tasmanian economy of over \$103m per annum. 52% of this comes from Thoroughbred racing, 33% from Harness and 15% from Greyhounds. In terms of direct employment, Thoroughbred provides 60%, Harness 22% and Greyhounds 6% (10.7% non-codes specific).

- Recognises economic output of codes

### ***Performance Incentives***

A performance based incentive component has been considered essential to ensure support for actions that improve revenue. These commercially based actions may disrupt industry traditions or be generally unwelcome for participants. Having an incentive based component helps align participant returns with sensible commercial decisions that benefit the industry as a whole.

Due to potential choices that may need to be made particularly around scheduling, it is considered important that international revenue be incorporated into any incentive based component. This ensures that where choices need to be made that will benefit international revenue to the detriment of domestic revenue, the specific code allocation does not "suffer" as a result, but rather can benefit from supporting sound commercial practice.

- Recognises commercial performance (including ROI)
- Promotes growth
- Promotes the alignment of interests
- Acknowledge and cater for code specific features

### ***Keeping It Simple***

Transparency in any model for allocation is critical to ensure participants understand the concepts and the implications. It also helps allay any suspicions that the model is biased or misleading.

The key to transparency is to ensure the model is as simple as possible and hence understandable by a wide target audience within the industry.

- Promotes transparency

### **Length of Operation**

The previous model has been in operation for the full three year period as originally intended. Any new model introduced may be significantly impacted by changes in sustainability that may occur in the short to medium term regarding the Tasracing business model. A longer term view of allocations is considered a benefit to participants in relation to funding surety. It is intended that any new model will be in place for three years but Tasracing will reserve the right to review the model earlier if required.

### **Draft Proposals**

The following three examples are presented for discussion purposes and illustrate different aspects of the principles.

#### **Example 1** Retain the existing model.

The existing model comprises the weighted average of the following:

- 1- A fixed percentage for each code (50% weighting).
- 2- National turnover share of each code (15% weighting).
- 3- Average Sky Meeting turnover (35% weighting).

The weighted average deciding the codes share of the total code pool (i.e. the prior year's funding plus the CPI increase component).

Outcomes include:

- No change to existing model
- Intercode rivalry
- Strong performance incentives
- Funding reductions possible for individual codes

**Example 2** shows a code allocation model that has three components;

- 1- Each code has a fixed component equivalent to the previous year's funding.
- 2- Each code receive an increase based on 50% of the CPI Increase component
- 3- Each code receives a proportion of the remaining CPI increase based on their average share of national turnover on Tasmanian racing over the past three years plus a domestic turnover equivalent of their share of international revenue.

The fixed component, using the previous year's allocation, (thoroughbred-54.86%, harness-26.35% and greyhound-18.79%) is broadly representative of the economic activity identified by IER for each code. Hence the historical basis is broadly aligned with current economic activity.

	Thoroughbred	Harness	Greyhound
Economic value	52%	33%	15%
Direct employment*	60%	22%	6%
Current distribution	54.8%	26.4%	18.8%

*\*Non-code specific employment makes up 10.7%*

International turnover is not currently reflected in the performance metrics, yet some decisions to position product for international exposure may impact a codes domestic performance. Therefore recognising international performance remains a consideration. The domestic turnover equivalent of international revenue will be calculated using international revenue divided by the average RFF revenue received as a percentage of turnover across all codes over the preceding financial year. As an example RFFs are currently calculating at 1.65% of turnover domestically. Where \$100k of international revenue is generated, this would equate to \$6.06M of domestic turnover ( $\$100k/1.65\%$ ) and be added to the turnover performance measure.

Each code will receive half of the total CPI increase plus their portion of turnover share. This ensures that each code will receive an increase each year.

The use of turnover share as the performance measure for the incentive component is an easily understood measure and widely used in other racing jurisdictions around Australia. Turnover is a key driver for RFF revenue. The use of a three year average ensures allocations are protected from volatility.

Consideration could also be afforded to decreasing component 2, the fixed 50% of the CPI component, which would weigh turnover performance more heavily.

Outcomes include:

- Ensures each code will receive close to CPI increases annually
- Reduces intercode rivalry
- Retains a performance incentive, including international performance

**Example 3** proposes a code allocation model that has two components;

This is a more sophisticated performance model that reflects key commercial metrics and provides a way to compare individual code's performance against their prior performance.

1. Each code has a fixed component equivalent to the previous year's funding (similar to example 2).
2. The CPI increase component will be allocated based on a range of criteria which align with key commercial metrics.

The criteria will be based on;

- a. Average starters per race
- b. Average races per meeting
- c. Total Sky races per year
- d. Turnover growth (including International equivalent)

Each of these criteria will generate a score based on a comparison with each code's previous three year average where a 10% increase will score the maximum of 1.0 and a 10% decrease will score the minimum of 0.0 with a sliding score between these two extremes (Greyhound average starter numbers will be calculated differently due to the box limits). This means a codes performance is assessed and rated against their own performance.

Based on the FY10-FY12 performances for each code the following target ranges would have been calculated:

	Average starters per race range		Average races per meeting range		Total races range		Turnover growth range	
	Min.	Max	Min.	Max	Min.	Max	Min.	Max
Thoroughbred	8.96	10.96	7.39	9.03	551.70	674.30	0.75	20.75
Harness	8.28	10.13	8.13	9.93	682.80	834.53	0.50	20.50
Greyhound	7.57	8.00	9.12	11.00	1428.60	1746.07	-5.29	14.71

In the above table the Average starters per race for thoroughbreds over the past three years was 9.96. The minimum for the Average starters per race range is therefore 90% of 9.96 or 8.96. The maximum is 110% of 9.96 or 10.96. The same calculations have been used for all other ranges except for Turnover growth which is simply plus or minus 10% of the three year average and greyhound average starter numbers which is based on the prior three year average plus or minus the difference between that average and the maximum 8.

An average of the four criteria will constitute the code score. The three code scores will then be weighted according to the previous year's total share percentages to allocate the CPI increase.

Using FY13 actual results would have generated the following code scores:

	Criteria results				Criteria score				Code Score
	Av Starters	Av Races	Total Races	TO Growth	Av Starters	Av Races	Total races	TO Growth	
Thoroughbred	9.53	7.97	622.00	11.62	0.28	0.36	0.57	0.54	0.44
Harness	9.39	8.99	773.00	0.16	0.60	0.48	0.59	0.00	0.42
Greyhound	7.79	10.43	1637.00	6.93	0.50	0.70	0.66	0.61	0.62

In the above results the thoroughbred average starters for the year are 9.53. This calculates as an average starters score of 0.28 between the 8.96 and 10.96 target range (where 8.96 is 0.0 and 10.96 is 1.0). This is calculated as follows  $(9.53-8.96)/(10.96-8.96)$ . With the same calculations done for each criteria the average of all criteria scores calculates the code score.

Each code score is then multiplied by the prior year's allocation shares (LY weight- see table below) to determine a weighted calculation that determines the relative share each code will receive. The above scores would have resulted in the following allocation of the CPI increase:

	Code Score	LY Weight	Calc	Final %	CPI Allocation
Thoroughbred	0.44	54.1%	0.24	50.9%	\$ 277,164.17
Harness	0.42	27.1%	0.11	24.3%	\$ 132,263.62
Greyhound	0.62	18.8%	0.12	24.8%	\$ 134,772.21
			0.47		<b>\$ 544,200.00</b>

In the above table thoroughbred had a code score of 0.44. When this is multiplied by their previous year share percentage of 54.1% it derives a relative weighted calculation of 0.24. the 0.24 then represents 50.9% of the total relative weighted calculation for all codes of 0.47. The 50.9% is then the thoroughbred share of the CPI increase component.

Under this model if all three codes had identical code scores (e.g. 0.70) then each code would get an increase equivalent to CPI. If one code scored higher than the others then that code would receive an increase above CPI while the other codes would receive less than CPI.

Outcomes include:

- Reduced inter-code rivalry
- Performance incentives aligned with commercial metrics

## Assessment of Options

As assistance to assessing the options, the following table provides a subjective assessment of the three options presented against the key principles identified.

<i>Principle</i>		<i>Option 1</i>	<i>Option 2</i>	<i>Option 3</i>
Sustainability	Affordability for Tasracing	High	High	High
	Promotes sustainability for participants	High	High	High
	Holistic view of the industry	High	High	High
Funding Stability	Reliable and consistent funding and product	Low	High	Medium
	Participant confidence	Low	High	Medium
Recognising Economic Impact	Recognises economic output of codes	Low	High	High
Performance Incentives	Rewards commercial performance (including ROI)	High	Low	Medium
	Promotes growth	High	Low	Medium
	Reduces misalignment of interests	High	Low	Medium
	Acknowledge and cater for code specific features	Low	Medium	High
Keeping It Simple	Promotes transparency	Low	High	Medium

The following table indicates the distributions that would have been calculated for each example for the FY14 allocation:

	FY13 \$M	Option 1- Actual		Option 2			Option 3		
		FY14 \$M	FY13 Change	FY14 \$M	FY13 Change	Change to FY14 Actual	FY14 \$M	FY13 Change	Change to FY14 Actual
<i>Thoroughbred</i>	\$11.78	\$12.24	3.9%	\$12.05	2.3%	-1.6%	\$12.06	2.4%	-1.5%
<i>Harness</i>	\$5.90	\$5.88	-0.4% *	\$6.03	2.1%	2.5%	\$6.04	2.2%	2.7%
<i>Greyhound</i>	\$4.08	\$4.19	2.6%	\$4.24	3.8%	1.1%	\$4.22	3.3%	0.6%
<b>Total</b>	<b>\$21.77</b>	<b>\$22.31</b>	<b>2.5%</b>	<b>\$22.31</b>	<b>2.5%</b>		<b>\$22.31</b>	<b>2.5%</b>	

\* Topped up to be 0% outside model

## Consultation Process

This paper is stage two of a three stage consultation process for the Code allocation model review.

Item	Date	Responses requested by	Status
Code Allocation Model Consultation Paper #1	Monday, 3 March 2014	Friday, 28 March 2014	Complete
Code Allocation Model Consultation Paper #2	Thursday, 15 May 2014	Friday, 30 May 2014	Ongoing
Code Allocation Model Draft Proposal	Friday, 6 June 2014	Monday, 30 June 2014	*
Tasracing Board to approve Final Code Allocation Model	Wednesday, 16 July 2014		*
New Code Allocation Model operational	Friday, 1 August 2014		

\* To Be confirmed

Tasracing will be finalising the preferred code allocation model in June for presentation at the June industry forums with a final decision to be made at the July Tasracing Board meeting.

**Written comments on this paper are requested to Tasracing at the earliest opportunity for consideration in the June presentation.**

Chris Brookwell (CFO) and Daron Heald (Business Analyst) are available to meet if required. Please contact Daron on 6212 9310 or [d.heald@tasracing.com.au](mailto:d.heald@tasracing.com.au) to discuss.