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HARRAH'S FULL HOUSE

BY WILLIAM HOLDER '75

GARY LOVEMAN TRADED A FACULTY SPOT AT HARVARD BUSINESS SCHOOL FOR A CHANCE TO RESCUE A COMPANY WHOSE NAME IS SYNONYMOUS WITH CASINO GAMBLING—HARRAH'S ENTERTAINMENT

Gary Loveman '82 was having dinner on the mezzanine level of Harrah's showcase casino, the Rio in Las Vegas, but unlike the hundreds of people gathered below him at card tables or slot machines, he wasn't having fun. He'd ordered pasta but didn't receive a pasta spoon. The waiter, though friendly, forgot to offer bottled water. No one cleared away his used Sweet'N Low wrapper when he had coffee. Just another picky and irritable customer? Hardly. The source of Loveman's displeasure was not that he, the chief executive officer of Harrah's Entertainment, received substandard service, but his unwavering belief that any customer in a Harrah's property should be treated better.

After dinner Loveman called the waiter and the restaurant manager to his table for a short lecture on proper service, a fitting reproof from a former faculty member of Harvard Business School. Since joining Harrah's in 1998, Loveman has been on a mission to imbue all 45,000 employees in Harrah's 26 casino properties across the United States with a single proposition: The business lives or dies according to the quality of service every employee provides customers.

This professor who never dealt cards has defied numerous skeptics in the gaming industry by engineering a classic corporate turnaround. In the mid-'90s Harrah's was struggling, but it's now the most profitable gaming company in the United States. *Forbes* says Loveman "has made Harrah's Entertainment...a model of effective customer feedback." The value of the company has tripled during his tenure, and earnings increased 12.4 percent to $235 million in 2002.

Yet when former chief executive officer Phil Satre hired Loveman as chief operating officer in early 1998, he didn't tell his board of directors until the deal was closed. The gaming industry rarely hires from outside. To import a theoretician from Harvard who had never managed a lemonade stand was audacious, at the least.

"I had never considered the notion of leaving Harvard," says Loveman. "It's true that I had reached a point at Harvard where things were starting to feel a bit routine. There's a hollow feeling that comes from giving advice to executives but never applying the advice yourself. This was an opportunity to see if I could do what I had been telling others to do."

Loveman was no stranger to the company when Satre offered him a job during a breakfast meeting at Harrah's in Atlantic City. An expert on consumer-service companies, he had consulted for Walt Disney and McDonald's and had served as a part-time instructor for Harrah's in-house executive training program. Rave reviews of his ability led Harrah's to ask for his help in devising a marketing strategy to build customer loyalty.

He left Harvard just a year shy of consideration for tenure. His colleagues were surprised, but most supported his desire to test his theories in a real management position. He traded in his professor's income of $120,000 (before consulting fees) for a salary and option package now worth millions a year, his Honda Accord for a Ferrari F-355 Spider, and his commute to Cambridge for a physically taxing routine of working weekdays in Las Vegas and spending weekends with his family in Massachusetts. Use of a corporate jet eases the strain somewhat, but he confesses to being perpetually in a time-zone limbo.

His presence in the gambling industry, the *New York Times* observed, "represents a culture clash as jarring as hillbillies in Beverly Hills." The son of a factory worker and a homemaker in Indianapolis, Loveman was driven and competitive. By his senior year in high school, he had become a top-ranked tennis player in the state. At Wesleyan he graduated Phi Beta Kappa. He overcame a modest math background as an economics graduate student at MIT and eventually won a prestigious Alfred P. Sloan Doctoral Dissertation Fellowship.

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"If he had an objective, he made sure he met it," says Professor of Economics John Bonin, who served as Loveman's senior thesis adviser. Loveman turned in a hefty 200-page work that took a considerable amount of Bonin's time. After receiving the thesis, Bonin recalled going home to find on his dining room table "a huge basket of fruit, with a note thanking me for my time and apologizing to my family."

At Harvard, Loveman established a reputation as a star in the classroom. Susan (Pratt) Arndt '87 says his course on service management was extremely popular and revealed his focus on customer service.

Loveman's arrival at Harrah's came as the company was foundering following a period of considerable success. In the late '80s, Nevada and Atlantic City were the only places with legal casino gambling. In the early '90s, Iowa legalized casino gambling, followed soon after by Illinois, Indiana, Mississippi, and Missouri. Harrah's led the way in exploiting these untapped markets. At a new riverboat casino in Tunica, Miss., customers stood in long lines and paid $20 to board for a two-hour stint of gambling.

"When Harrah's first opened in Joliet [Ill.], it was like the repeal of prohibition," Loveman says. "It was unbelievable. The profitability was staggering."

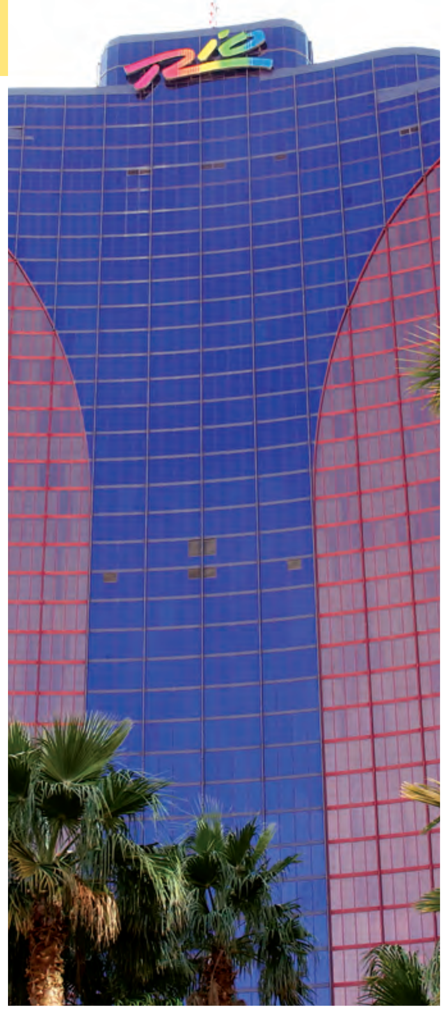
The scent of profits lured other companies, which built more lavish facilities to attract customers. The first Harrah's casino in Tunica cost $49 million to build. The most recent casino, built by a competitor, cost $600 million. The new markets rapidly became saturated, and no new markets opened in other states.

At the same time, a frenzy of casino building on the Strip in Las Vegas created 15 of the world's 16 largest hotels, each grander than the last. The Bellagio, built at a record cost of $1.8 billion, entices customers with its $300-million art collection. The Venetian, an all-suite hotel with 3,000 rooms, features an indoor canal with gondola rides and singing gondoliers who push past a replica of the Bridge of Sighs to the ersatz Piazza San Marco, where one can enjoy an "outdoor" meal under a painted sky. The Mirage features a 70-foot volcano that erupts every 15 minutes. Harrah's had nothing to match these opulent destination hotels, and business, says Loveman, "really went over a cliff."

A constant stream of cars, taxis, and buses pull up in the circular drive of the Rio, discharging passengers who have one thing in mind: gambling. Inside, they are not likely to be disappointed. The sprawling casino floor offers 1,700 electronic slot and video poker machines as well as more than 70 table games of blackjack, craps, baccarat, roulette, and more. Look above and costumed dancers are performing on elaborately decorated platforms that move along tracks in the high ceiling. The floor is a cacophony of music and flashing lights set against the constant din of slot machines. It's a non-stop, pumped-up environment that runs 24 hours a day, every day of the year.

Customers typically use a Harrah's Total Rewards Card, which works like a debit card in slot machines but also qualifies users to receive comps. Depending upon the level of play, comps may include discounts at any of the Rio's 14 restaurants, a cut rate at the salon and spa, complimentary tickets to shows, or even free rooms.

Behind the Total Rewards Card is a $100-million information technology system designed by Loveman



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Loveman has used the Total Rewards Card to build the most sophisticated customer tracking and analysis system in the entertainment industry.

and high-powered specialists he has hired. Around Harrah's, they are jokingly referred to as "brains on a stick." Bet in a slot machine at any Harrah's facility nationwide, and the company takes note of who you are, where you are from, and how much you are betting. Using sophisticated modeling software, Harrah's not only knows what kind of player you are, but also will predict what kind of player you might become, given the right inducements. A customer may receive an offer of a free steak dinner if the card is used within 30 days. Based on the customer's behavior, Harrah's may modify its predictions about future behavior—always with the goal of persuading customers to return with the minimum possible inducement.

With more than 25 million gamblers in the database, Harrah's has a technology-based marketing system that no other gaming company can match. Says *Forbes*: "Harrah's may be the best example of this kind of ongoing feedback system that could be applied to theme parks, ski resorts, cruise lines, retailers, and subscription businesses such as AOL and satellite TV."

Harrah's marketing program, combined with a company-wide campaign to improve service to customers, quickly began to produce results. After a successful test marketing program conducted in the Memphis area during January 1999, the company spent the rest of the year implementing its new strategy and started meeting its financial projections. "We had many managers who felt disempowered and helpless," Loveman says, "and we did a lot of theatrical things to get people feeling that they are in control and are in a fight that we need to win."

Suddenly, another hurdle emerged.

In 1999 Harrah's bought the Rio, which was then the preeminent casino and hotel in Las Vegas. It had the best restaurants, the best night life, the best entertainment. The glamorous world of high-rollers swirled around the Rio. But the jewel in Harrah's crown quickly presented a major challenge for Loveman to overcome. The opening of the Bellagio, the Venetian, the Aladdin, and other destination casinos created 15,000 new hotel rooms and 16 new restaurants. The Rio needed to adapt, but the management team, ensconced for 10 years, resisted change. Loveman was reluctant to fire them "for fear of messing up what they did well."

By year 2000, the Rio was undermining Harrah's turnaround. Frustrated, Loveman used his analytic skills to dissect the Rio's business and came to a surprising conclusion: the company was losing money on the high-rollers. He began to contemplate walking away from the sexiest business in town.

In his book *Jackpot! Harrah's Winning Secrets for Customer Loyalty* (2003), Robert L. Shook describes the impact that high-rollers can have on casinos.

"It was Saturday night and the Harrah's casino in Lake Tahoe was packed. Thousands of people were playing the slots; impatient customers stood behind playing customers and waited for them to vacate their seats at the table games. It was a good night for celebrity-watching. In the high-limit area, Charlie Sheen, Emilio Estevez, and a few of their friends were playing baccarat, and hundreds of passersby tried to catch a glimpse of the show business celebrities. Meanwhile, beyond the gawkers, at the next table an unassuming man from Hong Kong was hardly noticed. Yet high-ranking managers of the casino were carefully watching every card of baccarat as it came out of the shoe. The Asian bet huge sums of money on each hand, sums that dwarfed all others in the casino. On this particular night, the casino's entire profits or losses were dependent on whether this one individual won or lost."

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"Whales," as they are known in the gaming business, receive a level of service beyond the imagination of ordinary people, according to Shook. Casinos will dispatch private jets to ferry them and house them in palatial suites covering as much as 45,000 square feet. A Harrah's executive recounted buying a $50,000 diamond ring as a birthday present for the wife of a whale who had lost a lot of money. Casinos will buy Italian suits, underwrite five-figure shopping sprees, provide a new Mercedes—whatever it takes to secure the business of someone who may lose $10 million over a weekend.

Loveman was prepared to abandon this business. In 2000, losses to whales significantly lowered Harrah's earnings for two consecutive quarters. "No one involved with this business could give it up; it was so sexy," he says. "It was bringing in $60 to $70 million in revenue a year at the Rio, but at the end of the day we were losing money. One of the toughest things in business is to walk away from revenue, but we recognized we were going to make more money without that."

So he said goodbye to the high-rollers and replaced the management team at the Rio. Harrah's resumed its upswing.

The decision to drop high-rollers is consistent with Harrah's roots in slot machines. Slots first appeared in the United States during the California Gold Rush of 1849, but it wasn't until the Great Depression that their popularity soared. Bill Harrah, founder of Harrah's, realized that slot machines offered predictability in a business that could be highly unpredictable. Customers could not develop skills that would give them an advantage over the house, and slots don't require salaries or fringe benefits.

Today thousands of electronic slots offer a huge variety of games in Harrah's casinos. They are the most profitable part of the business and feed the marketing database with a continuous gusher of information. They provide gambling for the masses, and it's the masses, mostly older people—not the swanky—who patronize Harrah's.

"We are the most family-unfriendly business you will ever find," Loveman recounted during a Wesleyan reunion seminar in 2002. "Families have no time and no money. The best customer is someone who is 55 or over, reasonably affluent, and likes recreational activities. If you watch movies like *Ocean's Eleven*, you think of gaming customers as gowned women and tuxedoed men. That's not it at all. Walk into one of our casinos and you will find a sea of largely older customers. They are absolutely the target group of our business."

Loveman believes the only way to keep these customers from wandering down the street to another casino is to offer superior service. When he first arrived, he stalked the floors of Harrah's casinos incognito and discovered that the most experienced managers were taking weekends off—the busiest time. No more. Now Harrah's has an orientation, which explains to employees that, as for an athletic team, the weekend is prime time. After the weekend, executives analyze results, sort out mistakes, and get ready for the next Friday. Like a coach, Loveman thrives on the constant feedback, the never-ending challenge to win again.

"The struggle to be a great service company is daily. It's like diet and exercise. You did it yesterday, but you still have to do it tomorrow," he says. "It is the hardest thing to do well in a business such as ours that I've ever seen. We train and role play. We have one of the few bonus programs in the industry for great service by employees."

After all, customers are losing money. Harrah's challenge is to make that a more enjoyable experience than in the casino next door.

Is this any way for a Harvard business professor to make money? Loveman relishes questions about moral legitimacy. The days are long gone when Bugsy Siegel, with the backing of mobsters Meyer Lansky and Lucky Luciano, operated the Flamingo hotel in Las Vegas as an underworld playground. Las Vegas is strictly corporate and subject to intense regulatory scrutiny. When Loveman joined Harrah's, he had to provide investigators a list of his and his wife's family trees to three generations and 10 years of complete financial records, even lockbox keys. Investigators talked to his business associates, his neighbors, and asked his daughter if he ever did anything wrong. His accountant speaks to regulators so often that he maintains a special charge code for Loveman. All 13 states in which Harrah's operates investigate him every year.

There can hardly be any doubt about the popularity of casino gambling. When the Pequot tribe opened Foxwoods in Connecticut in February 1992, the staff was prepared for two shifts. At 2 a.m. the next morning, the first shift was held over to accommodate the relentless crowds, and the second shift reported early. The casino immediately undertook a massive hiring and training program and has ever since run 24 hours a day, all year, with 6,000 slot machines and 350 gaming tables.

Loveman insists that Harrah's is providing a service: gambling entertainment. He cites studies by the Harvard Medical School's Division of Addictions showing that of people who gamble frequently, about 1 percent cannot control themselves, but these people tend to have clusters of addictive behaviors, and they tend to be attracted to the ubiquitous state lotteries (47 states have lotteries). Harrah's will not market to anyone who self-identifies as a problem gambler.

Yet, controversy about gambling goes deeper. Jackson Lears, professor of history at Rutgers University, wrote in the *Chronicle of Higher Education* that "gambling reveals fundamental fault lines in American character, sharp tensions between an impulse toward risk and a zeal for control. America has two narratives of character, he suggests: One implies "a contingent universe where luck matters and...net worth may have nothing to do with moral worth." The other narrative "assumes a coherent universe where earthly rewards match ethical merits and suggests that Providence has ordered this world as well as the next."

"Debate about gambling is never just about gambling," he adds. "It's about different ways of being in the world."

Lears believes that risk-taking is becoming more acceptable in the United States, which would be good news for Loveman. Although he has succeeded in capturing a significantly greater share of gambling dollars for Harrah's and has won accolades from Wall Street, Harrah's needs new markets in order to grow. Those markets won't open without legislative action in states that do not have legalized casino gambling, and the outcome is no more a sure thing than the spinning wheel of a slot machine.

But with Gary Loveman arguing the case, the house may have an advantage.

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Behind Loveman is the casino floor of the Rio in Las Vegas, with 1,700 electronic slot and video poker machines.