Loveman Plays New Game at Harrah's After Tapping F-16s of Debt

Karl Taro Greenfeld

Gary Loveman, the chief executive officer of Harrah's Entertainment Inc., the largest gaming corporation in the world, sees his customers as a set of probabilities wrapped in human flesh.

First he considers the most basic set of probabilities, gender and age, since females are more regular gamblers than males and older women are the most lucrative demographic of all. Then he factors in where we live, what we do, how much we make, and, most important, how we wager and what we play when we come to one of his casinos. From those details, Loveman can divine to a remarkably accurate degree how much you, or the set of probabilities you represent, will be worth to Harrah's over the course of your lifetime.
"I am purely empirical," Loveman says in Bloomberg Businessweek's Aug. 9 issue, sounding like the former Harvard Business School professor he is. "I am not attached to any romantic notion of how this business should be run. I am only driven where the evidence takes me."

Loveman is a unique figure in American business: an academic theoretician who made the transition to operating a multibillion dollar corporation.

Uncommon career path aside, he's not much of a gambler. He sees the floor at Caesars Palace as his storefront, and the people at the craps and blackjack and roulette tables and at his beloved slot machines -- those computerized boxes that pay out less than craps tables and gather so much more information -- as the customers Harrah's must strive to please. The happier they are, the more pleasant their experience at one of Harrah's 52 casinos, then the more likely the set of probabilities embodied in each of them will continue to pay out for Loveman.

Boom Years

When you look out at a casino floor, you see people playing blackjack or the slots; when Gary Loveman looks out at that floor, he sees his slots or his table games playing you. "Mathematics is the language of logical expression," he says, "and my mind works very logically. I have found in the casino business that is a great help most of the time."

Since taking over as CEO in 2003, Loveman, 50, has relied on the numbers to build Harrah's from a regional operator of 15 casinos to one with 39 in the U.S. and 13 more overseas.
He snapped up properties during the boom years, buying the World Series of Poker and three casinos from Binion's Horseshoe for $1.5 billion in 2004, Caesars Entertainment for $9.3 billion in 2005 and the Imperial Palace in Las Vegas for $370 million later that year. In 2007 he spent $600 million to acquire a golf course in Macau -- the largest piece of land in the fastest-growing, most lucrative gaming market on the planet, according to the American

Gaming Association. Late last year he bought the Planet Hollywood Resort & Casino in Vegas, once worth $1 billion, for just $70 million and the assumption of $550 million in debt.

Slot Boxes

These were what Loveman calls "high-probability" purchases; each acquisition, except for Macau, provided immediate revenue growth as Harrah's Entertainment emerged as the largest owner of real estate on the Las Vegas Strip. In October, Harrah's plans to change its name to Caesars Entertainment.

"My sort of logic excels at things like acquisitions or expansions or developments," he says, "where I can look at the numbers and make it a defined, deductive problem."
The numbers also compelled Loveman to reject the traditional Vegas business model of spending billions to build bigger, more lavish "slot boxes," as he calls the opulent casinos that dominate the strip. They tend to produce fantastic revenue their first year or so; after that, their performance steadily deteriorates as "other, better boxes are built."

Customer Targeting

Instead, Loveman concentrated on building loyalty among Harrah's customers. Before he got to Vegas, casino marketing meant spending big money to lure "whales," industry parlance for extremely wealthy gamblers, to town. Loveman went broader, compiling a vast customer database and sending targeted offers and come-back-soon inducements to millions of people with the desired probabilities.

The program has driven gaming revenue -- far more profitable than food or hospitality -- to 80 percent of Harrah's $9 billion business, versus an industry average of 45 percent, according to the gaming association.

Harrah's shareholders profited in 2008, when private equity firms Apollo Management and TPG Capital took Harrah's private for $30.7 billion, the last big leveraged buyout of the pre-crash era; stockholders took home $90 a share as Loveman and his new partners increased Harrah's debt load to $24 billion. Apollo and TPG didn't fare as well. Their deal valued Harrah's equity at $17.1 billion; today it is valued at $7.2 billion, according to data compiled by Bloomberg.

Worst Decision

Loveman's way with the numbers, he admits, can also be a weakness. It was responsible for the worst decision he has made as CEO, a mistake he's been trying to rectify for the past four years: his 2006 refusal to bid on a $900 million gambling concession -- and one of just six gaming licenses -- in Macau. He bought the golf course a year later in a belated attempt to get in on the action.

"The quantification on Macau took me in the opposite direction," he said. "You had to have a kind of intuitive courage and I am not well suited to those kinds of decisions."
Because he passed on the deal, Harrah's is for now locked out of the industry's most important emerging market. "Big mistake. I was wrong, I was really wrong."

Missing Macau

Harrah's, and Loveman, are still paying the price. As Vegas swooned, Macau boomed to the point where competitors such as Las Vegas Sands and Wynn Resorts are now making more revenue in the coastal Chinese city than they do in Vegas. As rival CEOs Steve Wynn and Sheldon Adelson of the Sands made the decision to pile into Macau, the numbers told Loveman to stay out.

“I try to be self-reflective of the fact that this is a short-coming of mine,” he says. “I am trying to address that vulnerability by asking myself over and over again if I am over-thinking the problem. Am I missing something?”

Loveman is sitting in his office on the second floor of the Palace Tower at Caesars -- just upstairs from the counter where they give out the towels for the Garden of the Gods Pool Oasis. It’s a vast rectangle decorated with wood panels, overstuffed chairs with beige stripes and a maple bookcase with a signed Super Bowl XXXV helmet, models of Harrah’s fleet of jets and photos of Loveman with various notables. The decor is C-suite Modern -- Loveman can’t say who did the tropical-themed painting of a veranda and garden that hangs on the wall. “Reggie?” He shouts to his assistant. “Who is responsible for the painting above my desk?” She blames the design firm.

Weekends in Boston

He is a large man -- 6 foot 1, roughly 250 pounds, and “uncomfortable in the gym,” as he says -- with brown hair, square face, large jowls, no neck. He dresses simply; on an early summer day -- 108 in the shade -- he’s wearing black shoes, grey slacks with a white pin stripe, a blue shirt and an orange tie. He speaks in a gravelly voice and a steady, Al Gore-like drone of impeccable diction and complete sentences. When it comes to interviews, he has certain ground rules. His family is off-limits.

“There are three reasons for this,” says Loveman, who lives with his wife in a suburb of Boston, has three children in college and flies home from Vegas on weekends in a corporate jet.

Postal Probabilities

“One, I have 80,000 some-odd people working for me here and a small number of them are likely to be unhappy with me for some reason -- we’ve laid off their wife, they’ve lost their health benefits, something,” he says. “The second is that we are in the middle of a long and unpleasant negotiation with the UAW over unionizing one of our Atlantic City operations. And the third is there are a number of people who think gambling is the devil’s work and that I am a consummate devil because I am a smart devil.”

Gaming CEOs are known to take extreme security precautions, in part because one never knows the intentions of those who, as Loveman puts it, “may have an adverse result at the casino.”

If a bundle of probabilities goes postal, he doesn’t want to be there for it.

Vegas Before the Fall

The last time I visited Las Vegas, in May of 2007, the U.S. economy was booming, shrugging off the first waves of the housing crisis and Bear Stearns was still a going concern.
It was the weekend of the Oscar De La Hoya/Floyd Mayweather junior middleweight title bout, then the highest-grossing fight in boxing history, and everything in town -- a room, taxi, table -- required waiting in line. The nation’s wealth was everywhere on display, and every casino was jammed. The skyline itself was rapidly transforming, as huge construction

projects -- $55 billion worth of mostly junk-bond-financed "slot boxes" -- promised to give gaming executives even more opportunities to cash in on favorable probabilities.
The casinos were then so flush that deals like the leveraged buyout of Harrah's Entertainment -- and the billions of dollars in debt taken on by competitor gaming companies such as MGM Resorts International and Las Vegas Sands -- made sense to everyone involved: the bankers who were underwriting it, the hedge funds who were buying it and the casino owners who would be servicing it from the easy money they were sure to keep raking in.

Loveman and his Apollo and TPG partners had run the numbers, gone through the probabilities and concluded that servicing their $24 billion debt load was only a matter of maintaining single-digit gaming growth.

2007 Peak

Primarily on Loveman's loyalty program, Harrah's had achieved annual double-digit growth for the previous half-decade. The plan of the private equity investors was to take the company public after a few years and rake in billions in management fees, dividends, carry charges and initial public offering profits.

That fight weekend was among the best in Las Vegas history. Casino drops were fantastic, according to Harrah's, and occupancy throughout the town was 99 percent. Total Las Vegas gaming revenue would peak in 2007 at $10.9 billion, before falling to $9.8 billion in 2008 and $8.8 billion last year, according to the Las Vegas Convention & Visitors Authority. Harrah's worldwide revenue fell, too, from $10.8 billion in 2007 to $8.9 billion last year.
On the June weekend three years later when I flew in to meet Gary Loveman, the half-dozen building projects that had started in the midst of the boom, financed in part by all that debt, were stalled and mothballed.

Financial Engineer

With the Las Vegas Strip's gaming revenue down from $6.8 billion in 2007 to $5.5 billion by 2009, the demand for more slot boxes just wasn't there, nor was the revenue to service the debt. Huge projects like MGM Resorts' CityCenter required a $270 million infusion of crisis funding. Boyd Gaming had halted construction of its $4 billion Echelon Place, the $3 billion Fountainebleau had filed for bankruptcy.

Although Harrah's had not taken part in the slot box boom, it had expanded, then taken on vast debt for a leveraged buyout at precisely the wrong time.
"One wouldn't choose to do this in advance of a consumer spending collapse," Loveman concedes. He was forced to find $600 million in cost savings to survive 2009 and had to reinvent himself as a financial engineer.

'Thinking of Surviving'

"Summer of '08 was an inflection point,'' says Harrah's Chief Financial Officer Jonathan Halkyard. ''We went from thinking of growing to thinking of surviving.''

Loveman, meanwhile, had gone from running a public company and answering to a board and shareholders to running a private company, along with his private equity partners, and answering to his debt-holders.

''The balance sheet had become our adversary,'' he says. ''You look at the situation in October 2008 and revenue is falling away in an unprecedented way. We had created value by taking care of the customer and providing a good experience, but as of the second week of October 2008, that wasn't going to be enough.''

By early 2009 investors were anxious about holding more than $14 billion worth of notes that were trading as low as 13 cents on the dollar. Harrah's had just reported its fourth straight quarter of losses; the middle-class gamblers that Loveman had cultivated were staying away from the casinos. Loveman describes what happened next as ''learning a new game.''

He had been brought in to solve a marketing issue, yet suddenly he had to address a balance sheet issue. Renegotiating a crippling debt load in the face of the biggest financial crisis of his lifetime was not something he'd taught at Harvard. ''I had to get good at this fast,'' he recalls.

Digging In
Halkyard recalls watching Loveman turn the crisis into an opportunity. ''Gary is not just conceptually very smart. He is willing to get into details. He digs in.''

Loveman concluded Harrah's had to reduce debt and debt servicing expenditures, so the company executed 13 capital markets transactions, Halkyard says, reducing debt by about $4.5 billion and pushing out the maturities to buy time. Harrah's ended 2008 with $24 billion in debt; today it owes about $19 billion.

What Loveman was doing, with a huge assist from Marc Rowan, managing partner of Apollo, and David Bonderman, a founding partner of TPG -- ''the F-16 pilots of debt refinancing," as Loveman calls them -- was making holders of Harrah's debt an offer they couldn't refuse: Trade your old debt for new debt, and take a haircut in the process.

The alternative? Loveman didn't need to spell it out: Watch your investment shrink to nothing as Harrah's is crushed by its own debt. You could pay a little now -- a few billion -- or pay a lot more later.

Game Theory
"It was poker," Loveman says. "It was game theory, something I'm very comfortable with. It was a matter of recognizing and anticipating the decision of the other actor when confronted with the information that would become available to them. Here is the choice set that is available to you, so what are you going to do?"

Loveman knew the answer before he asked it. It was just a matter of figuring out the probabilities.

Theory Into Practice
Growing up in Indianapolis, Loveman was among the first white kids in town to be bused to a predominantly African American high school. He was a good student, having inherited an aptitude for mathematics from his father, an engineer for Western Electric. The youngest of three siblings, he became an unlikely combination of math geek and popular jock, the only white player on the basketball team at Thomas Carr Howe High School.

"I have always been able to get along with a wide range of people successfully," he says. "I think it has something to do with why I was able to go from academia to business and not be repellent to everyone."

Loveman attended Wesleyen University, earned a Ph.D. in economics at the Massachusetts Institute of Technology and put in two years as an economic researcher at the Federal Reserve Bank of Boston before joining Harvard Business School. While at Harvard he became interested in customer service, a subject most quants shied away from.
"My studies up until that point had been in disciplinary economics," Loveman says. "There was very little formalization of service as a discipline. There is a long history of research and engineering around factory optimization, scheduling, throughput. On the other hand, the service sector was seen as a poor cousin."

In Demand
When he talked about customer service in his classes, he noticed, his students perked up. We all live as customers, he realized, not plant managers or finance directors. He applied his quantitative background to the subject and proved a link between happier customers and more profitable companies, a connection described in his 1994 Harvard Business Review paper "Putting the Service-Profit Chain to Work."

Soon after its publication, Loveman was in demand as a speaker, consultant and seminar leader for major corporations eager to cash in on his idea that labor was more than a function of cost and that happy employees led to repeat customers who spent more. He says that executives from virtually every industry were interested in hearing his ideas, save one. Asked to lead some Harvard-style case studies with groups of Harrah's hotel and gaming executives, he saw that "the gaming guys wouldn't show up, or if they did, it was clear they hadn't done the reading. They just didn't evidence any curiosity about this subject. They just weren't intellectually curious about anything."

Loveman had been in a casino only once in his life, a quick walk through one in Monte Carlo when he was 26. He played a few hands of blackjack, observed that the odds were against him and lost interest.

Letter to Satre
Now, as he considered where his ideas about customer service might best be applied, he realized that casino gambling was precisely the kind of commoditized business -- what's the point of differentiation between this slot machine or that craps table? -- where customer service could make a difference. In 1997 he wrote a letter to Philip G. Satre, the CEO of Harrah's, outlining some of his ideas.

In 1998, as Harrah's was about to embark on wave of expansion, Satre asked Loveman to take a break from Harvard to become chief operating officer of Harrah's Entertainment.
"In terms of income, it was actually a pay cut," Loveman says, since he had to forego the consulting that supplemented his income as a professor.

Know Your Customer
His first big move as COO was to start a loyalty program called Total Rewards, which became such a success -- growing to over 40 million members by 2010, the largest database of probabilities in the industry -- that by the time Satre stepped down in 2003, Loveman had become the logical choice to succeed him.

"Obviously," says Loveman, "as CEO, I've more than made up for whatever income shortfall I initially experienced." The value of his salary, stock options and deferred compensation at the time of the Harrah's leveraged buyout was $90 million, according to SEC filings. Today, the Total Rewards program remains the linchpin of Harrah's success. The first loyalty program in the industry to be applied across every casino in a company, it allowed for a more accurate analysis of betting patterns -- probabilities -- and a more equitable distribution of "comps" or free rooms, meals, show tickets and the like. In the past, such perquisites tended to go to the flashiest high rollers and the noisiest comp-seekers, not necessarily those contributing the most to Harrah's bottom line.

Loveman instituted a similar program for Harrah's staff, who are given points, based on customer satisfaction surveys, that can be redeemed through a website for products. Even Harrah's C-suite executives have their compensation pegged to customer service scores.

Being Unsexy

To analyze the customer data it collects, Harrah's spends about $100 million a year on information technology, compiling preferences and probabilities that led Loveman to a startling conclusion. Harrah's makes more money from elderly slot machine players than any other demographic in the casino -- even the high-rolling millionaires casinos traditionally spent fortunes luring and flying in by private jet.

"The slot player was the forgotten customer," Loveman says, "and the slot player offered us the biggest benefit in terms of collection data. ... I had to be willing to be unsexy in this. I can take you to a casino that would have a lot of young beautiful people in there and you would say, 'Man, this is a happening place.' I could take you to another place where there are a lot of people who look like your parents. The latter would be a lot more profitable than the former. My job is to make the latter."

Engine Room

Although Loveman has remade Harrah's as an old-fashioned service sector juggernaut, the firm does have a newfangled engine room. The motor is the database, maintained in Las Vegas servers and managed out of One Harrah's Court, the old corporate headquarters where the IT and marketing departments now reside. Spend a few days at a Harrah's property, and the information the company compiles about you will end up here, analyzed by proprietary software that assigns each and every Harrah's guest a theoretical value. The higher the value given to you -- not to be misconstrued as a source of pride -- the more likely you are to lose your money to Loveman.

During a recent visit to Harrah's, I sat with two members of the Total Rewards staff, Matthew Bowers and Andrea Mathews, as they pulled up the profiles of various players. Thirty-year-old "A" from Chicago, for example, is a female slot player who has made 36 trips to Harrah's Chicagoland casino in Illinois, playing an average of 47 minutes per trip and losing about $156 each time she plays. She is an active buffet customer, and Harrah's will entice her back soon with bigger and better buffet offers.

$529 Sucker

Next, Bowers and Mathews pulled up my profile. I had spent exactly 8 hours and 34 minutes gambling. They had on my screen the games I played, the duration and the value I represented. They knew, for example, that I had sat down to play Pai Gow Poker at 12:39 p.m. and gotten up from the table one hour and six minutes later. I had bought in for $800 and cashed out for $1,300. That was among my better gambling sessions that trip.

They had tracked what I'd eaten, how much I'd spent and where I'd shopped. Based on my age, gender, zip code and gaming preferences, they had assigned me a theoretical value of $529, meaning that was how much they expected me to lose every time I came to a Harrah's property.

"You're a good player," said Bowers. "You'll be getting an attractive offer from us." Then he smiled at me. "Please, keep playing."

Which meant I was exactly the kind of sucker they were looking for.

Debt Restructuring
Harrah's is likely to be around for many years, separating probabilities from their money. After the debt restructuring Loveman engineered in 2009, less than 1 percent of Harrah's debt comes due in the next two years. By contrast, competitor MGM Resorts has 15 percent of its debt scheduled for repayment in that time, according to the company. On Aug. 4, Harrah's reported a $274 million quarterly loss; Loveman said he was "encouraged by the recovery" in Vegas.

Returning to double-digit growth, however, requires Loveman to undo his big mistake -- not acquiring a gaming concession in Macau.

Of the three areas of potential gaming industry growth, Loveman has positioned Harrah's to succeed in two. If Internet poker is ever legalized, then his World Series of Poker is likely to be a dominant brand.

Ohio to Massachusetts
And as casinos open up in more states across the U.S. -- Ohio last year became the 25th state to legalize casino gambling, according to the National Conference of State Legislatures, and Massachusetts appears deadlocked over the details of a legalization bill -- Harrah's, with $3 billion in cash and available credit, is poised to expand into these emerging markets. The third area -- booming Asia, where Loveman missed a big chance -- remains a challenge. "Gary did an incredible job getting the company through the liquidity crisis," says Frank J. Fahrenkopf Jr., president and CEO of the gaming association. "Now he needs to figure out Asia."

Loveman's 2007 purchase of the 175-acre Orient Golf (Macau) Club, which Loveman has described as a "$600 million round of golf," was an attempt to make up for not bidding on a gaming concession a year earlier.

An Asian Recovery?

Without a license -- the Chinese government has allowed six and shows no inclination to increase the number -- the land is valuable, just not as precious as it would be with a big, fat Caesars Palace sitting on it. Loveman, who is also chairman of the Harrah's board, and his private equity partners have been working steadily to change that, either by purchasing a share of a concession or lobbying the Chinese government.

It was in part to fund whatever Asian expansion becomes possible that Harrah's in June swapped $710 million in debt held by John Paulson, who also owns stakes in MGM Resorts and Boyd Gaming, for 9.9 percent of the company, which puts Harrah's current value at $7.2 billion. As part of the deal, Paulson, Apollo and TPG bought from Harrah's an additional $557 million in bonds.

Paulson will be allowed to register and sell his shares, though Harrah's and its private equity partners say they still control the timing of an IPO. Paulson does not have a board seat. Eventually, Harrah's will go public again, providing capital for its Asian expansion.
Bouncing Back?

"There are two scarce resources in Macau," Loveman says, "land and gaming licenses. If you wish to have a resort in Macau, you need to have access to those two things. We have one of them."
If Harrah's establishes itself in Asia, Loveman will have completed a remarkable career journey.

First, he was a business school professor who saw his theories succeed in practice. Then, a crisis manager who learned a new skill set. And finally, an executive who bounced back from a serious error in strategy and found a way into his industry's most important market. Or not: That chapter hasn't been written, and a post-IPO Harrah's may or may not have Gary Loveman at the head of the company. Someone who analyzes the probabilities as carefully as Loveman has no doubt studied those odds.

He says he is prepared for any eventuality. When he left Harvard back in 1998, he recalls, he thought of it as a sabbatical anyway.