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Public Gaming:

On January 31, The NY Lottery will start selling Powerball in ad-

dition to MegaMillions. This is an incredibly fantastic accomplishment that will increase net funding for lottery beneficiaries. We can be quite confident that net impact on sales will be positive. But how positive? Is there any kind of projection as to the net impact on sales that selling a second big multi-state jackpot game will have?

Gordon Medenica: We're reluctant to throw out a hard number, because the dynamics of this kind of initiative are actually quite complicated, but we firmly believe it's going to be significant. For example, MegaMillions has been our star game this year. I think year-to-date through nine months we're up over 28% on MegaMillions. So, we need to anticipate that next year MegaMillions will be down a lot. I don't know what "a lot" means, but it'll be down. Now, we also know that having the two games will smooth out some of the volatility because people will likely just play the game that is rolling up at the moment. We were hit last night with MegaMillions at \$165 million, but Powerball is still rolling in the low \$100s. We can't sell that now in New York but, hopefully, we will by February and that will keep the momentum going. Our sense is that you will see faster and higher roll-ups as a result of both games going all the time. So, to evaluate results, we'll look at the financial performance of MegaMillions and Powerball together. In fact, we're even having a discussion about our own financial statements and whether we should just consider that one line, Mega and Power. We'll probably show it separately just for our own information, but eventually, I think that will just be one category, the jackpot category.

The main point is that there was a ton of market research done on this. It was done state by state. It was done in total. It was done with a lot of different assumptions and variables. Most of us are hoping for, and expecting, double digit net percentage increases. We are all quite confident that this will be the biggest growth vehicle for the lottery industry for the next year and probably two years. But we probably should not get much more specific than that at this point.

Might the more frequent roll-ups and more rapid climbs to high jackpots raise player expectations for fresh and new and exciting game changes? How will the games evolve to meet those expectations?

G. Medenica: We've got a three phase strategy going forward to keep everything fresh and exciting. First is to implement the cross-selling in as many states as we can. Then, based on how we assess the dynamics of the marketplace, we may choose to take one or even both of the games to a \$2 ticket. I think we're all looking forward to seeing how the player dynamics are going to develop with both games being available everywhere. And as you know, all of the Mega states that are going to be selling Powerball are going to offer the multiplier, Powerplay, with it. And all of the Powerball states that are going to be selling Mega are going to be putting a multiplier on Mega. Part of that is to preserve the matrices of both games. Obviously, neither consortium is changing the matrix, but to keep from disrupting the matrix and getting sales that generate too much coverage on the games, the multiplier feature basically absorbs some of the sales dollars into the multiples of the secondary level prizes. So, depending on how that goes, the second phase may include a change in the base rate of one or both of the games to a \$2 game. And then the third phase is to add still another game, a Premium Game, which will be a totally new game that is in development now, at potentially an even higher price point such as \$5. (I prefer calling it a "Premium Game" instead of 'National Game' because I think Powerball and MegaMillions will both be "National" games.)

We don't necessarily have all the answers yet and we don't know exactly how everything will evolve, but I can tell you we have thoroughly mapped out the strategies to truly optimize performance in all different kinds of scenarios. And, to use the cliché, it's all good.

You've pointed out that this is a top line driven business. To push sales into the double digit growth range would have quite dramatic impact on states and lottery beneficiaries. The net result will be somewhat determined by the things that you as the operator do in the way of brand management strategy. Can you explain a little bit more about what you'll be doing with respect to brand management strategy to optimize the net impact. For instance,

what changes are you making to preserve the momentum of your in-state lottery?

G. Medenica: It's all about smart portfolio management. You want to have enough different kinds of games to appeal to all player types, but at some point there is a diminishing return when you get too many games. But let me go back to when we were first thinking about implementing Powerball almost a year ago. Our in-state lotto game had been in decline ever since we launched MegaMillions. Now, the revenue increases from MegaMillions always offset the decline in our in-state lotto, so we were okay with the shift from one product to the other. But last year, our in-state lotto was down some 16%. So it was finally getting to the point where Lotto was starting to die. As a percentage of our total sales it was less than 2.3%. That's hardly enough to keep it in the portfolio. It wouldn't survive the competition from the second super jackpot game, Powerball. So what are we going to do with Lotto? First of all, our in-state lotto is priced at two games for a dollar. So even though you can't buy one game, it's technically a fifty cent game. Years ago we had tried to raise it to one dollar per game, and it killed Lotto sales and we actually had to reverse that decision and go back to two games for a dollar. So even though we wanted to drive the price point on Lotto, our previous experience indicated that raising the ticket price would just exacerbate its decline even more. And then there was the other issue of being competitive on the size of the absolute jackpot. A Lotto jackpot of \$12 million just does not generate the excitement and attention of the Mega jackpots that exceed \$100 million. Yet, a common thing that we hear in the market research and in focus groups is people asking, "Why does one person have to win \$100 million – why can't 100 people win \$1 million each?" And so we thought, with a couple of little tweaks, we could change Lotto to a million dollar cash top prize, not annuity, with multiple top prize winners, at one buck a game. We could reposition it away from the jackpot arena and play to this segment that wants to play for better odds to win a \$1 million cash jackpot. That was the genesis of Sweet Million, our reinvented in-state jackpot game. Then, of course, Powerball didn't happen last year when we thought it would. We were all prepared to actually replace Lotto with

Sweet Million, so we went ahead and launched Sweet Million anyway, and kept classic Lotto as well. And given the games' characteristics, their player appeal, the similarity of matrices and things like that, we viewed Sweet Million, Lotto, and our Take 5 game as being very competitive to each other. And so we analyze the results of all three together. We have come to a better understanding of the dynamics of how these three games appeal to slightly different player preferences. And Numbers and Win 4 appeal to yet a different player group. We will be adapting our portfolio management strategy accordingly to fine tune the marketing and positioning of these different products to appeal to the different, narrower, player segments. And even though Sweet Million is still not a very significant game in terms of overall contribution to the portfolio, it has seen a net increase, it has stopped the decline in Lotto, and we have evolved a strategy to retain the interest of small but, when the games are all added together, important segments of our player base. So we are very happy with reversing the trend and getting growth back for our in-state lotto games. And I think we have learned something in the process about our customer base. There is a demand for more than just the super jackpot games and we want to have the products available to meet the needs of all of our customers. We don't expect our in-state games to cut into the momentum of the super jackpot games. And frankly, we won't over-invest in the marketing and support of these smaller categories. But no matter how dominant and profitable one game, like MegaMillions and Powerball, becomes, we never want to lose sight of the importance of smart portfolio management and meeting the needs of the smaller market segments. We need to truly understand our customer and portfolio management because now we will need to integrate the second super jackpot game and soon we will likely have the Premium Game. We need to find the most synergistic portfolio management strategy to get the biggest net increase from the addition of these new games.

Why did some of the Powerball states originally object to the cross-selling concept when it was voted on a few months ago?

G. Medenica: You should probably ask them instead of me. But I will make the observation that some jurisdictions really live and die by their Powerball sales. MegaMillions comprises less than 10% of our total sales. That's big but we can easily manage the risks of making a change to the portfolio of games. We can model the impact of introducing Powerball and know that we can manage the overall impact on our other games. But what if Powerball comprised more than 50% of revenue, as it does in some states? Of course,

as was ultimately decided by those states, adding MegaMillions will be a positive change. But the nature of this change is quite a bit different for them and they were rightly concerned that something this major be done with thorough due diligence and forethought. We needed to eliminate as many of the uncertainties as possible and get the most well-conceived action plan in place before launching. That's what we have done, 36 states are on board and more will be joining, and so now it's full steam ahead.

What else can be done to minimize the risk and optimize the net results of the addition of the second super jackpot game?

G. Medenica: I think it comes down to marketing. Get your retail network up to speed on the new game. That is a big job and we can't underestimate the importance of retail education that has to take place for this to be successful. We've got a tremendously powerful story to sell. The increased number of draws and jackpot roll-ups sets everyone up to succeed at increasing sales. But it won't happen without solid marketing and retailer and player education. It comes down to basic execution, basic blocking and tackling. That's what will separate the single digit increases from the double digit increases.

Keep in mind that it's not as if we are establishing a whole new brand here. The consumer is already familiar with one jackpot game. And many of them are familiar with the other because of hearing about it in a neighboring state. I think everyone knows what to do and how to do it. And I think 2010 will be a very good year for U.S. lotteries.

The cross-selling Powerball-MegaMillions initiative required open-minded thinking and overcoming countless obstacles to make it happen. It seems to me that the success that lotteries have had in forging this collaboration should open doors to other opportunities and other kinds of collaborative initiatives.

G. Medenica: Of course. We simply need to ask ourselves, "Where do we have common goals and agendas?" Two such issues jump immediately to mind, and you're very familiar with both of them. The first would be Internet gaming, and the issues we have vis-à-vis the federal government, and particularly the DOJ (U.S. Department of Justice). Several jurisdictions are working together to communicate our thoughts and concerns to the DOJ, and to other areas of the federal government as well. The second issue is closely related to Internet gaming, but is actually a more immediate concern. That's the whole credit card coding issue, which, thankfully, has been pushed back another six months due to the delayed implementation of UIGEA. Still, it continues to be a constant struggle about how our

credit card transactions are classified so they can be legally processed. This is definitely an area in which cooperation and unified effort on the part of all lotteries will produce results that will benefit all lotteries. These are issues which affect all lotteries in the same or similar ways and so we have common agendas. This is where a natural cooperation between lotteries, and vendors too, will evolve. I've never found it to be difficult to get other states and lottery heads to join forces and to work together to accomplish a common agenda. While we do work together on these kinds of issues, we are never sure of the results we'll get. Our ability to lobby and exert influence at the national level is quite limited. We are sort of confined to dealing with our individual constituencies in terms of political influence.

Why couldn't NASPL be used as an agent to lobby at the national level?

G. Medenica: Maybe it can. We are exploring those possibilities now. Think about how the MPA, the Motion Picture Association, operated and the power they exerted on the movie industry; the way it was regulated at the national level, the way that the rating systems were developed, and all those other things that were very much influenced by their industry association. We don't really have that mechanism to advocate for the lottery industry right now. But we are definitely looking at our options and, specifically, how NASPL could be used to exert more political influence to advocate for lotteries at the national level.

Creating the Powerball – MegaMillions deal involved a tremendous amount of work. Many problematic issues had to be overcome. Now that the two consortiums are learning to work together, working through our differences, learning to trust one another and dealing with different work-styles and approaches to problem-solving, I am hoping that working together, as a whole industry, on a nation-wide basis, will be easier to do. I hope that our success in this endeavor will perhaps lead to bigger and better ways of cooperating nationally as an industry.

I would suspect that a year ago there were some people who wondered how much time they should spend on something that they were not confident would ever get off the ground. The success of this initiative should give everyone the confidence to go after ambitious goals that require mutual support and collaboration. Like creating an entity, or using NASPL, that could lobby on a national basis for the interests of state lotteries. State lotteries can't get budgetary funds allocated for a purpose like that but perhaps there is a way to use your association to do it.

G. Medenica: That's the tough issue, funding. How do specific state rules apply to the ap-

plication of NASPL funds towards a purpose like lobbying at the national level? I think the vendor community would be willing to participate and contribute to funding that kind of an effort. But it gets tricky on a political level. Can NASPL accept money from the vendor community that would be a contribution to lobbying? Can state lotteries pay dues to an organization that acts as a PAC? It would be a very good thing for both states and lotteries if we could address our concerns satisfactorily, because we really do need to have an advocate on Capitol Hill. Everyone else in the gaming industry is spending huge sums to lobby on their behalf, and lotteries have no voice, no advocate to even explain our point of view. So, our congressional representatives who are making decisions on issues like Internet gaming, sports betting...they get an earful from everyone except state lotteries. That is not good for the interests of the state or the public.

A slightly different area that I am wondering might have potential for collaboration between lotteries... When I see all the TV commercials competing for the Batchy Awards, I'm quite astonished at the quality that's being produced and the amount of money that must be spent to create all this television advertising. It seems to me that there are many commonalities between all these commercials and that the 40+ U.S. lotteries could get together and share some of those costs. Wouldn't there be potential costs savings of tens of millions of dollars. Do you have any thoughts on the possibility of creating a collaborative effort between lotteries to produce TV commercials?

G. Medenica: It has been discussed. The problem lies in the fact that lotteries have restrictions about what can be said and done in the advertising. And those restrictions and guidelines differ from state to state. That makes it very difficult to produce a commercial that is compliant with all these different rules. For instance, the Washington State Lottery made a wonderful commercial called 'Every Bird Should Fly' and made it available to other lotteries to use. It won the best of the Batchy's. But I don't think it has been used by other lotteries. (Editor note: the WA Lottery confirmed that nobody has used it as of January 1, 2010.)

Now you're going to point out that just because you can't get everyone to sign on to a cooperative cost sharing program doesn't mean you couldn't benefit by getting ten or even five or even, for that matter, two lotteries to split the costs. You know we have considered the possibilities because we've all discussed it together with Leo Mamorsky (DDB New York advertising executive who manages the NY Lottery account). The analogy I use is that on the systems, support, and ticketing side of the business, we have just a handful of major vendors between GTECH, Sci-

entific Games, Intralot, Pollard. All the lotteries benefit by having a lot of commonality so that the cost of providing solutions is brought down and the quality and effectiveness of those solutions is brought up. I think the vendors benefit as well from economies of scale and being able to leverage their R & D and product development to support a large number of customers, and receive the increased revenue from those extra customers. Think about how less cost effective it would be if every online contract were serviced by a different company which needed to incur all the R & D and product development costs as well as acquire the skill sets on the human resources side of the business to service just one contract. Obviously, the costs of doing that would be much higher. Theoretically, this same dynamic would apply to the advertising side of the business too, with significant efficiencies to be gained by spreading the costs between two or more lotteries. DDB New York is our agency and they are a part of the Omnicom Group, which houses a large number of agencies all around the world. There are a number of lotteries which are serviced by agencies which are also a part of the Omnicom Group. You'd think we could at least get these agencies to work together. But the advertising world does not seem to work that way. Even in the case of the Omnicom Group, the agencies work independently from each other. They don't really operate as divisions of the same company. Looking at the way these agencies within the same company tend to compete with each other instead of cooperating makes me think that getting advertising agencies to work together is difficult at best. There are other obstacles, and when you add them all up, it may just be more trouble than it's worth to try to collaborate on advertising.

I suppose everyone likes to think that their market is unique and what works in New York wouldn't work in other markets.

G. Medenica: And of course there's something to that, of course there are differences. I respect the fact that advertising creatives do try to be relevant to their specific markets and produce campaigns that really resonate with the citizens of the specific regional market. But still, there are also many commonalities and so we shouldn't necessarily allow the fact that there are differences in regional markets to prevent us from leveraging those commonalities. But it's true that this perception of differences is certainly an obstacle. And, most of the ad agencies would not see this as a benefit to them and would want to convince the lotteries that it would be a big mistake to try to forge a collaborative approach to advertising. Maybe what we need is a visionary from the advertising side of this indus-

try to champion this kind of innovation. Lotteries themselves have always been very generous about sharing this kind of thing with one another, so I think they'd have a receptive audience.

Having said all that, I do think there are benefits to be gained by lotteries working together on advertising. And in fact, there's an interesting effort going on right now related to the Powerball MegaMillions launch to collaborate on a campaign that would be national in scope. For example, we explored the possibility of buying a Superbowl spot. Something like this has never made sense before and may well not make sense ever again. The Superbowl is scheduled for February 7th, one week after the targeted launch date for many lotteries to sell both multi-state jackpot games. This fortuitous timing created the impetus to do something on a big scale, like a Superbowl ad.' We offered to produce the spot and to put a significant contribution towards the media purchase. GTECH also agreed to be a sort of charter funder. We opened it up to all the member lotteries, and we got a lot of support. Lots of support and lots of people willing to pitch in. But it looks like it's not going to happen. A Superbowl spot costs something on the order of \$2 million to \$2.5 million, and we ended up short by about half that number. But we're going ahead and producing a spot, and the spot promotes both games, Powerball and MegaMillions. We're going to offer it basically for free to anybody who wants to use it. As we talked about, that doesn't mean it will be used by everyone because all lotteries have their own set of rules and restrictions when it comes to advertising. Also, we need to work out the residual rights fees issues for talent, music and the like and how those are charged. These seem to be two stumbling block for producing ads that are shared between lotteries: the residual rights' fees issues and the need to re-work the ad for use in the individual jurisdiction.

The selling of both games in most of the lotteries does create even more incentive to overcome those obstacles. For example, to buy the Superbowl spots through the local affiliates would cost around \$300,000 in New York. If we could purchase the national spot for \$2 million and share the cost between 35+ lotteries, then that would obviously be a hugely cost effective campaign. So I think it's something that will happen eventually. It may not happen for the January 31 launch, but everyone's aware of the benefits and, I think, very supportive of the concept in principle. Everyone wants to find economic efficiencies, especially in advertising, since budgets are so tight everywhere. ♦