

## Joan Borucki

### Director of the California Lottery

State legislatures everywhere are turning to their lotteries to help solve financial deficits. The California Legislature recently approved changes that give the Lottery more flexibility to manage the business for peak performance and profitability. It's not just about increasing the prize-payout percentage. It's about setting ambitious goals, and then managing the lottery like a business to produce superior results. In an accompanying article, Director Borucki describes the impact of this new legislation. Below, the Director goes into more detail about the meaning of *Performance Management*, the *Renew Project*, the Lottery's three-year business plan, and the role that the Camelot Group plays in that plan.

**Public Gaming:** *Did you decide to not implement Powerball, or is it just going through an approval process?*

**Joan Borucki:** We are carefully analyzing it in the context of our three-year business plan, which we call the Renew Project. In that project we are also analyzing our in-state lotto game, SuperLotto Plus, because its sales have been declining. Clearly, we need to think carefully about how the jackpot games work together and how to create an approach that maximizes overall sales and profits. That could mean that we have three big jackpot games – Mega Millions, SuperLotto Plus, and Powerball – or it could mean having only two of those. We are trying to learn from our past game launches. Our introduction of Mega Millions in 2005 could probably have produced a better result if we had thought more about integrating it into the broader portfolio of our products. This time our planning process is more in-depth and is aimed at getting the most out of our entire product line.

The decision is also partly a function of our marketing budget. You need to have funds to market and promote the games. A big jackpot game like Powerball would probably generate enough profits to easily pay for marketing, but we still need to make the decision in a thoughtful way that gets the most out of our limited marketing dollar. We are pleased to be able to examine Powerball, along with a

whole host of other opportunities, in our Renew Project. One key change brought about by the Renew Project is that we now look at all of our business decisions using a rigorous economic analysis aimed at maximizing sales and contributions to education.

*The introduction of Powerball could disrupt your repositioning and rejuvenating of your in-state game, SuperLotto?*

**J. Borucki:** Yes, but the opposite could also be the case. An earlier launch of Powerball could possibly help us define the market for the in-state game. Getting clearer information on the markets and player preferences and how they segment themselves will inform the branding, and product positioning for Super Lotto Plus or whatever replaces it. Instead of three super-jackpot games, we will likely want Super Lotto Plus to target a slightly different market.

*So you might want to fast-track Powerball because that will inform the process of clarifying your in-state lotto game?*

**J. Borucki:** That's one of the alternatives we're looking at, Paul. I bring that up to let you know that we are in the process of assessing all different kinds of options. There are lots of different ways to look at the business, lots of pros and cons for many different alternatives. We are taking the time to thoroughly and systematically analyze them.



*It is a big win for the state of California and the beneficiary of lottery funding, education, for the legislature to give you more flexibility to manage the business for optimal results. This must be an exciting time for you and the Lottery. You have referred to The Renew Project and your three-year business plan. What are you and your management team doing differently to leverage all of your assets to produce the best results over the next three years?*

**J. Borucki:** That's a good question, and that is precisely the focus of the Renew Project and the 3-year business plan. We are excited but also anxious because with freedom to do more comes the responsibility to produce even better results. Last August we brought Camelot Global (operator of the UK National Lottery) on board as a consultant to help us review our various business processes.

We are looking at our short and long term plans for all of our instant and draw games – including Hot Spot – now that the Prize Payout flexibility law has passed. Working with all of our employees, retailers, and vendors like GTECH, SGI, Pollard, Camelot and our ad agencies, we are developing additional tools to help us sell more tickets. We are also looking at how to get the most out of our retail space and to use virtual media to our best advantage.

We are developing plans that will leverage technology and marketing best practices to sell to the players of today and tomorrow – not yesterday.

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The Renew Project set up a variety of teams of our employees to look at our business practices and policies. One team is focused on growing the draw-based lotto games. Another is working on our Scratchers. They're reviewing everything from design development, printing, distribution, how they're placed in the market, number of games. They've just gone over that entire work effort from top to bottom, and have already produced some changes that will contribute to our current fiscal year results.

At the start of the fiscal year we were projecting that we would be \$200 million below our sales goals for Scratchers. As a result of the Renew Project we were able to make changes, and meet the sales goal for the year for Scratchers. The changes were not dramatic, just basic changes to our field operation, such as improving how we interact with retailers and communicate what we expect from them, limiting the number of Scratchers we have on the market at one time and changing how we define the life cycle of our games. It was very gratifying to see such a quick return on the efforts of the Renew Project.

We're also looking at changing the way we invest our marketing dollars. The last couple of months we've only been advertising Mega Millions in San Francisco and Los Angeles. The L.A. market has over 50% of the state's population. Focusing our advertising in this way has produced excellent results. We have already seen a 25% increase in Mega Million sales since we started this campaign.

And then we've got a real push to create a performance management culture within the organization. What that means is to focus on results instead of process, and to get everyone in the organization to think that way. To support that change in culture, we are helping our workforce acquire the skills and the tools that they need to produce the results. One of those skills is project management. We have been training many of our employees on how to manage projects in an efficient and effective way that helps our organization.

So there's lots to do and everybody is quite busy making it all happen. But it's paying off already. We can see the results and clearly see where these initiatives are taking us, so we're very optimistic about the future. This was all done, Paul, on the premise that we were going to do everything we could to make the California Lottery be a truly great business, to optimize performance with or without the additional tool of prize payout flexibility. That's what the Renew Project effort is all about.

*Camelot Group brings in a different perspective, operating in a different part of the world, different gaming culture, different regulatory and competitive environments, etc. How will the relationship with Camelot be evolving over the next three to five years?*

**J. Borucki:** The first part of the work effort was all about preparing an assessment that showed how sales would decline if the Lottery took no action. Next we worked very hard on our business plan and identified quick changes that we could make to bump up our sales right away. The advantage of enlisting Camelot's support is that they have deep experience and knowledge about lotteries because they manage the National Lottery of the United Kingdom.. So they understand the industry – its needs, wants, challenges and opportunities.

Being a privately held company that is responsible to shareholders as well as the government of the UK has caused Camelot to become very adept at running the lottery like a business. One of their skill sets is the ability to convert business analytics and data into effective decision-making and planning processes. That's one of the things that I was really after. We didn't hire someone to come in to run the business for us. The California Lottery management team controls the business. And we also didn't want someone to come in and drop a set of 300-page binders on our desk. We needed a higher level of engagement, someone to be a partner in implementation as well as planning. Camelot has trained our team to employ a much more sophisticated approach to analyzing the business and focusing all of our business processes on maximizing the return on investment. Our staffs work well together and we are both pleased with the results. By the way, the learning experience goes both ways because politics, the media, our retailers, our business in California operates differently from the way Camelot operates in the UK.

The business plan is expected to be approved on May 20 by the California Lottery Commission. Then we'll start the next phase which is execution and implementation. We have Camelot on board for the next three years to help us with that execution. That will be the most critical part. A lot of people can come in and help you put together a plan. What's unique about this relationship is that Camelot is a partner who will stay onboard to help us fully execute the plan. They get paid on performance. Their compensation is based on our incremental growth.

*Some of the incremental growth would accrue from the changes in the law that was just effected by the state legislature. Like prize-payout flexibility.*

**J. Borucki:** Camelot does not get credit or get paid for that. They get paid for the sales increases that are impacted by them and their contributions.

*How do you differentiate between the two?*

**J. Borucki:** That is all spelled out in our contract. We actually agreed upfront as to how to adjust their compensation for things like increases caused by changes in prize-payouts. We have tried to structure the Camelot's compensation so that they get paid for their contributions and not for sales increases that would have happened without their support. That's not to say it is an exact science, but we have taken that into consideration and done our best to account for that.

*Excellent. The performance management culture...the notion of focusing on results more than process. Those of us in the commercial world would translate that into things like incentive-based compensation, i.e. commission, for salespeople. Did the law enable more flexibility to adjust compensation for your own salespeople to drive performance?*

**J. Borucki:** No. The law was very limited. In our last business plan we had talked about a whole laundry list of things that we had wanted to change, that being one of them. But this particular bill really only addresses the prize-payout flexibility that we've received. Plus it reduced the percentage of sales that I can use on administrative and operating costs from 16% down to 13%. But this current law really only dealt with giving us the prize-payoff flexibility.

*Tough customers. The legislature said...okay, you're telling us you're going to do better, so put your money where your mouth is. You'll be increasing total funding for education, but you'll also be increasing operational efficiency. So we'll take some of those cost savings and add that to the funding, thank you very much.*

**J. Borucki:** Yes, exactly. It was hard to argue with their logic! It was appropriate and quite honestly we're excited about the challenge.

*It certainly does sound that way. One of the objectives in the Renew Project is to terminate or modify activities that do not add value. That seems a very sensible thing. But where the rubber hits the road is deciding which activities to*

cut. The impulse is always to try to resurrect something that once had value and not to cut bait. Isn't it hard to have the discipline to take resources away from the lesser productive, lower ROI cost centers? Any examples of where you've done that?

**J. Borucki:** I have a very recent example: the "Make Me a Millionaire" TV show. The California Lottery has had a TV show on the air since day one. It used to be the Big Spin. When I came onboard, that show had very, very low viewership. The ticket sales were okay, but nobody had ever really looked at it to see what the show was contributing and whether we could be getting more out of it. So we revamped the show, tried to refresh it and reach out to new or lapsed consumers through a more up-to-date TV show. We developed this new concept with Three Ball Productions called "Make Me a Millionaire" TV show. We put out a new ticket that did very, very well during the first six months after it launched. The TV show looked better than anything you see on national networks. We gave away more money than any national network game show. We had allocated about \$19 million to the prize fund for the show and the ticket. We were tracking the sales and taking a hard look at the viewership and all the different agreements we had with the TV stations to run the show. We ran these numbers and came to the conclusion that the show was simply not adding enough value to our overall scratcher sales.

And now we have the flexibility to channel that \$19 million into other things like higher payout for scratcher tickets. The bottom line is that we determined that the show was not producing the same return on investment as other activities. As a result, we announced earlier this month that we would be cancelling that contract and the last show will air July 3rd. Now that's a hard thing to do. The California Lottery has always had a T.V. show. Like you say, it takes discipline to just walk away from something that has always been a part of who we are. But that's an example of how we are determined to run the Lottery like a very effective business. We are moving to operate more aggressively to ensure that every dollar is spent in the best possible way, maximizing ROI and ultimately funding for education in California.

*Great example. The law that explains the changes in payout percentages...Is it too complicated to explain exactly what the constraints are and how they've been changed?*

**J. Borucki:** Not at all. It states that no more than 13% of sales can be expended on operating expenses. That leaves 87% of sales for the Lottery Commission to decide how the prize-payout structure, i.e. what percentage goes to prizes versus the percentage that goes to education. The idea, of course, is that strategic changes in prize-payouts can increase gross sales and net profits that go to education. The caveat is that we must always

produce a year-over-year increase in funds delivered to education, which we intend to do..

*There was much discussion just a couple of years ago about "monetizing" or selling the state lottery. It seems like a better approach might be to "modernize" the lottery, to transform it from a state government agency into a performance-driven business. It sounds like that is what you're doing.*

**J. Borucki:** Policy makers have the responsibility of determining if they want to securitize the Lottery by getting an upfront payment for future sales. But the focus of our organization is to make the lottery the most successful it can be in terms of maximizing the dollars we earn for education.

We can and will deliver the results. We are giving our staff the tools to achieve superior results. Our focus on performance management, emphasizing results more than process, brings that entrepreneurial energy and culture to the California Lottery. Our legislature is giving us the support we need and we are going to deliver.

It's exciting that state legislatures are recognizing the potential of the state lottery and appreciating the tremendous asset they have in their own lottery staff and management team. Perhaps all that discussion about "privatization" served a good purpose if it piqued the interest and imagination of the state legislatures to re-evaluate how they thought about their state lottery. ♦

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a core attribute that will drive growth. The business model can be based on high product development and marketing costs that produce dramatic innovation because you're banking on high growth. You hope that it is profitable and it better be profitable because it includes uncertainties and higher risk. That's not the product life-cycle stage that lotto is in. We don't necessarily want to reinvent our super-jackpot products. They may be in the mature stage of the life cycle, but the way to manage them for maximum profitability is to innovate them back into the late-growth stage and not to try to recapture that early high-growth stage by reinventing the product, or by introducing dramatic changes to differentiate the products. We know we need to innovate to keep the products exciting and relevant to the player, but we do not want to go the high-risk, high-return route of completely changing our core products.

You want to appreciate that lotto is a very successful and profitable franchise. Our primary obligation is to protect the security and integrity of that franchise for the good causes that are our beneficiaries. The launch of both super-jackpot games is a hugely exciting innovation and we'll be very pleased and proud to see double-digit increases in sales. That in itself is pretty darn good. But it's not our mission to take high risks and gun for outsized results. So I would say that we are just as pleased and proud of the measures we take to minimize downside risks for all our stakeholders. We were confident that this would be successful, and our commercial partners have done an excellent job at executing. But again, the operative term regarding the cross-selling initiative continues to be 'cautiously optimistic.'

*Short-term results would seem to indicate that can be upgraded to "quite confidently optimistic."*

*How exciting it must be to deliver sales and profit increases in an economic climate that is so challenging. Do you think the success of the cross-selling might cause state legislators to look more favorably on allowing lotteries to have more flexibility in the ways they manage the business and perhaps authorize more games and otherwise support your ability to increase funding for good causes?*

**T. Rich:** Not in quite the way you are thinking about it. Of course, everyone loves the revenues. But I don't think it will cause legislators to change the conservative approach they have towards the lottery. In fact, we all need to continue to emphasize that our job is not just about promoting the games and increasing revenues. It is about managing a great business that balances social responsibility along with the entertainment desires of the public and the much-needed revenues that states desire in these economic times. ♦