

Alain Cousineau

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PGRI introduction: Based in Montreal, owned by the Provincial government of Québec, Loto-Québec operates the lottery, four casinos and related restaurant and hotel services, a video lottery network, network bingo activities, and a comprehensive suite of online gaming activities at www.espacejeux.com. In addition, Loto-Québec exports multimedia products to international markets and holds a financial interest in Casino Développement Europe and its subsidiaries, the third largest casino operator in France. A multi-faceted corporate enterprise, Loto-Québec anticipates changes in the marketplace and is an innovative early-adopter of new technology and progressive approaches to managing the business of gaming, gambling, and lottery. Following is a discussion about how those changes are impacting government lotteries, and how Loto-Québec integrates its public service mission into a highly competitive market-driven business model.

Alain Cousineau assumed the office of Chairman, President, and Chief Executive Officer of Loto-Québec on September 29, 2003. Prior to his appointment, he held a number of senior-level positions in both the academic and business sectors. The term of Mr. Cousineau's mandate expires Sept. 30, at which time Mr. Cousineau will leave the office of president and CEO of Loto- Québec.



Paul Jason, Public Gaming: Let's start by briefly describing the regulatory framework and how that has evolved in Québec, and Canada.

Alain Cousineau: The framework for the provinces in Canada is derived from the criminal code, which stipulates, with a limited exception for charitable gaming, that all gambling activity is illegal unless conducted and managed by the state, similar to the system in the U.S. The Canadian federal government assigned the responsibility to determine regulatory policy over to each of the provinces. Now, each of the provinces has total respon-

sibility for determining the regulatory framework and conducting and managing gambling activities. Aspects of the operation can be outsourced to commercial firms, but the law specifically requires the state to conduct and manage all gambling activities. Provinces are prohibited by federal law from outsourcing that fundamental responsibility. That applies to all the Canadian provinces.

In Québec it was decided at the outset that all gaming and gambling activity, other than horse racing, would come under the state controlled operator Loto- Québec. Other prov-

inces allow for the management of casinos to be outsourced to private operators, but not Quebec. Loto-Québec is charged with managing all aspects of lottery and gambling - not just the casinos, but the hotels, restaurants, the VLT networks, network bingo, and now Internet gaming and i-poker. And of course, all lottery products.

So as per Canadian law, BCLC for instance is required to exercise oversight and full responsibility for managing the casinos even though they opt to outsource large portions of the day-to-day management. Whereas, Loto-Québec opts to ex-

ercise hands-on operating control over all business functions of the casinos and even the hospitality and other businesses ancillary to the casinos.

A. Cousineau: That's exactly the way it is. I think we're the only province that really operates every aspect of the lottery and gambling industry. That's very different from what you see in the U.S., and actually different from almost anywhere in Europe too.

What do you see as the advantage or disadvantage between exercising more operational control versus outsourcing portions of that control?

A. Cousineau: The jury is still out on what is the best model. For that matter, it would certainly vary depending on the circumstances and public policy objectives of each jurisdiction. So I will not attempt to make a judgment call on that. Besides, lottery directors don't make those decisions. We basically inherit the model we work within and focus on optimizing the return to our stakeholders within that construct. What is more interesting about the Canadian provincial model and the Loto-Québec model in particular is the breadth of gambling activities that are under its control. There are two main reasons for this model: protecting the player by channeling the economic activity in controlled circuits, and minimizing social costs by "managing" the consumption of games of chance. It is not about generating funds for Good Causes or government. It's not that we are trying to reduce consumption; it's more about maintaining equilibrium between supply and demand. When it comes to gambling, consumer demand will always be satisfied one way or another. If Loto-Québec does not provide a safe and secure option that endeavors to minimize problem gambling and social costs, then the demand will be met by the underground market and that does not have the interests of the players or the general public as core to its mission.

Having oversight over the entire gambling industry changes the whole perspective about how you think about phenomena like the Internet. A new channel of distribution like the Internet is seen not as a way to sell more product or great way to connect with the 'millennial generation' or anything like that. It's seen as impacting the equilibrium of an entire industry. It's our job to make sure that the impact is positive or to at least minimize the negative impact. It's our mission to make sure that technological, cultural, economic, and sociological change is all integrated into the fabric of the gaming industry such that social costs are minimized. Anything that

has the potential to upset the equilibrium of the broader gambling industry must be dealt with in a proactive manner. We monitored the i-gaming markets over the past many years. Insofar as demand stayed below a certain threshold, it was not necessary to provide an additional option to the marketplace. As the i-gaming activity increased, though, the negative impact of a thriving underground economy changed that. It became necessary for Loto-Québec to provide a safe, secure, and controlled outlet for that demand to be met. Our entry into that space was really not for the purpose of increasing sales, but to minimize social costs and protect the player.

The role of Responsible Gaming, then, is much different when you are responsible for more than just lottery.

A. Cousineau: Exactly. It is a well known fact, and very well documented with extensive research, that lottery has much lower social costs than VLT's and casino-style gambling. Of course, the operator focused solely on lottery also gives attention to Responsible Gaming matters. But the incidence of problem gambling amongst lottery players is not as high as it is for VLT's and casino-style gambling. So the perspective and overall mission for the operator that conducts all forms of gambling is different than it is for a lottery-focused operator. Responsible Gaming must be the cornerstone to our corporate mission. Our DNA is Responsible Gaming. The DNA of Loto-Québec is not about Good Causes, or financing public services, or bringing back money into the government. These are consequences not the finality of our "raison d'être". The state created our organization to channel the demand into controlled circuits for the purpose of protecting the player and to minimize the development and consequences of problem gambling by "managing" the consumption of games of chance.

A private company is certainly capable of implementing an effective Responsible Gaming agenda, isn't it?

A. Cousineau: Absolutely. I would respectfully submit, though, that the very nature of private enterprise could not embrace Responsible Gaming in the same way as does a state-owned operation. It could never be the cornerstone to their mission for the reason that shareholder value is, almost by definition, the DNA driver of a commercial corporation. Again, that's not to say that private enterprise is not capable of delivering the highest standards of goods and services that enable the accomplishment of a mission that

includes social responsibility. It's just that policy-makers in Quebec feel that control is best kept within this framework that really frees us up to value these non-monetary objectives higher than the profit objective.

That is the same reason Loto-Québec entered the VLT market?

A. Cousineau: There were between 25,000 and 50,000 illegal units operating in Québec that were generating an estimated CA \$600 million for illegal operators. No player protection, no management of consumption, no taxes to the state. It was the responsibility of Loto-Québec to channelize that into the regulated sector. And that is precisely the same reason we are implementing an ambitious Internet gaming agenda – to channel the illegal activity into a safe, regulated, and taxed circuit.

We have an interesting challenge. Our games and value-proposition have to be engaging enough to attract the players. Otherwise they will stay with the illegal operators. But our objective, paradoxically, is to manage the consumption. We want all players to play on Loto-Québec's site, but we do not want to stimulate or maximize consumption. We want to manage consumption so that nobody plays too much. This is an even bigger theme than minimizing problem gambling. It's about sustainable development, which is a concept that should be applied in some fashion to all economic activity. Because of the nature of our business, we are scrutinized more than almost anyone. That creates a wonderful opportunity for Loto-Québec to be a model for sustainable development which has the potential to influence other sectors of our economy, many of those completely unrelated to gambling and lottery. We take that responsibility very seriously and hope that we can serve as an example, hopefully contributing to that broader societal goal of nurturing sustainable development in all sectors of the economy.

How do you determine the right time to enter a market?

A. Cousineau: There are two major drivers. One, we've already talked about, which is to channelize the demand once it hits a certain threshold. We started to seriously monitor the Internet gaming market in 2005. The market was not as big then and we determined that it did not require our attention at that time. As the market grew, the need for a safe and secure player option increased. The other driver is the political environment. The political and public debate over the proposal to move our casino closer to downtown Mon-

treat had died down. Our research data, by 2010, clearly showed that the market needed a safe and secure I-gaming option. BCLC and ALC were going forward with acquiring a fine tuned and ready for prime-time Player Account Management (PAM) system that would support a multi-jurisdictional approach. That is a critical component to the i-gaming model, especially as it relates to the social games like poker where liquidity and high number of players are required for success. For these reasons, we determined that this was a window of opportunity for Loto-Québec to obtain government authorization to move forward on the internet.

It is interesting how quickly you moved from concept to implementation in the Internet gaming space.

A. Cousineau: We do have the resources to invest in whatever objectives become high-priority. Our in-house IT infrastructure was already as sophisticated as anyone's in this industry. We have built that IT and acquired the operating competencies over many years of running the whole range of gambling products and services - from casinos, to distributed VLT networks, to lottery. So it was not difficult for us to form the team necessary to fast-track our Internet gaming agenda.

As you are speaking, it occurs to me that one of the most important ingredients is the management of public perception of gambling and Loto-Québec's role as caretaker of that industry. How difficult is it to enable the public and your political constituents to understand the public service mission and purpose of everything that Loto-Québec does?

A. Cousineau: We do not always succeed at that as well as we would like! For instance, we feel that a majority of the public supported the Cirque du Soleil Casino project in Montreal back in 2006 and that it was shouted down by a minority. The lesson learned is that it is vital to have political support, and that comes not just with a compelling business plan, but with the research that shows public support. Alignment with public image and public relations objectives is critical. So now we do extensive research, communicate that to our company shareholders and create alignment of purpose with our political constituents, and then communicate with complete transparency and integrity our agendas to the public. So you are right to acknowledge the critical role that public image plays in our industry.

Loto-Québec's commitment to Responsible Gaming and security is reflected in the certifications you earned from the World Lotteries Association (WLA). (These certifications are awarded

lottery operators that have proven the highest levels of achievement.) Do your political constituents recognize the relevance of those certifications?

A. Cousineau: Absolutely they do. Our minister is sometimes challenged to defend the actions of Loto-Québec and he uses the WLA certifications to support our claims to superior operational competencies and ability to deliver a higher standard of performance. The process of earning the WLA certification is very rigorous and only awarded to those operators that complete a most challenging program and are able to demonstrate the integration of the principles into a fully operational programme. The certifications do serve a useful purpose to help our constituents appreciate what we do and how we do it. But that's actually not the primary benefit of completing the certification process. The real benefit is derived internally, within our organization and the way it has guided us to think about our business. In short, we need to integrate the principles of responsible gaming and a wide variety of other considerations into every aspect of our business, from product concept to product development, to marketing, distribution, and advertising, into everything. That can be a difficult process because some of those considerations may appear to conflict with each other. We learned to embrace Responsible Gaming as an integral and complementary part of marketing for instance, and not as something that conflicts with marketing agendas. The certification process taught us how to internalize our mission in a holistic way so that everything we do is understood as an important part of the value we deliver to society. The real benefit of the WLA certification process is how it has improved the operation of Loto-Québec itself, completely apart from any PR agenda.

Is there a trade off between the missions of minimizing the social costs of problem gaming on the one hand and channelizing gaming revenues away from illegal operators on the other?

A. Cousineau: First, increasing revenue is not our mission. As regards to channelizing demand, that has more to do with creating access than with putting out games that are over-stimulating and likely to cause problem or addictive gambling. Attracting players away from illegal operators is really about making your products accessible and known to the consumer.

For example, we saw that our VLT revenue was increasing faster than we had projected, and possibly contributing to an expansion of the market. The revenue increases were not

caused by the VLT's themselves, though. It was not anything we were doing in game development that was over-stimulating player response. It was simply a matter of accessibility. There were over 3,700 outlets, with 15,000 units. The research indicated that we did not need to change the games, just reduce accessibility. That was the responsible move, that is what we did, and it had the intended effect

Reduce Sales.

A. Cousineau: Yes, but not that much. The impact on revenues was not significant – just enough to get us back into a supply-demand equilibrium. What really affected the revenues in 2006 was the smoking ban. That precipitated an immediate 20% drop in revenue. We estimate that the revenue decline of 2006 was 70% was related to the smoking ban and 30% related to diminished accessibility. Now we feel that we are providing adequate accessibility to prevent the proliferation of illegal machines and that is really our primary goal. And our patrons are not subjected to second-hand smoke!

You have mentioned that lottery has a much lower incidence of problem gaming than other activities like Casinos and VLT's. And that your mission is really driven by the public policy concern to minimize social costs and problem gaming. Doesn't that mean that lottery should then be promoted much more aggressively, that an increase in lottery revenue is in strategic alignment with the goal of minimizing social costs?

A. Cousineau: An increase in lottery revenue, especially if it were to come as a migration from other gaming sectors, would theoretically be, as you say, in strategic alignment with our mission. But there are two reasons why that notion is misguided. First, we have always promoted lottery and our per capita/per year revenues are already very high. The projections for demographic change over the next 10 years indicates that our target market of 35 to 65 year-olds (where the rate of play is the highest) will be decreasing as a percent of total population. Furthermore the 18-35 year-olds segment will also be decreasing over the same period while their three months rate of play has fallen from 70% in 1980 to 40% in 2010. This is what would need to be classified as a mature market, one which still has great profit-legs, but not necessarily as responsive to increased marketing expenditures.

Second, there is very minimal relationship between the lottery and the VLT/casino markets. You can't really compare them. Increasing lottery sales would not have any effect on VLT/casino sales. You will not succeed at

channeling demand away from VLT/casinos over to lotteries. 70% of Quebecers already buy a ticket at least once a year. The percent of Quebecers that go into a casino once a year is about 16%; and that play VLT's is about 9%. So they are totally different market segments. Getting more Quebecers to buy lottery, or getting the 70% who already buy lottery to buy more, will have no effect on the relatively much smaller percentage of people who play VLT's and casino games.

Another interesting lack of cross-over. We promoted an Internet card membership to our casino players and had just 2% of the casino players sign up. This would appear to indicate that people who go to casinos will not be the ones who play on the Internet. That is fine, of course. We are not trying to promote cross-over sales, or convince players to try out new venues and media. We just want to make sure that players come to Lot- Québec instead of playing with illegal underground operators.

You said that past generations of 18 to 35 year-olds played more lottery than the current generation?

A. Cousineau: Yes. Much higher rate of play in past generations. And we do not see the current generation of 18 to 35 year-olds 'growing into the lottery' like they did in the past.

Why the dramatic decrease in lottery play among the 18 to 35 crowd?

A. Cousineau: Because there are so many other alternatives in our world today. Not just because of VLT's and casinos. There is an explosion in recreational gaming options that appeals to social gamers, player-to-player competition gamers, etc.

What you're describing doesn't bode well for the future of traditional lottery.

A. Cousineau: I'm talking about the situation in Québec. We have a mature market with high per cap' sales. Increasing sales will be a serious challenge. And I don't think the Internet will provide a major boost for traditional lottery products.

I don't see in the near future any new implementation of casinos. We just got a new one in Tremblant, but there are no more planned for now. Our overall growth will probably come from getting a greater share of the internet gaming market. But even if we were to get 100% of the Internet gaming market, which will not happen, that would only add about \$100 million to our revenues. Our total revenues are CA \$3.6 billion, so that would be less than 3% of our revenues and an even smaller percentage of net transfers. It is important that we channel the I-gaming de-

mand to Loto- Québec's safe and secure website, but it frankly will not impact financial results in a meaningful way.

We thrive to produce the games that the consumer likes to play, because that is what they will end up playing one way or another. For example, we implemented electronic table games when we could not do live-dealer tables. Then, when we could have live-dealer games, the players migrated over to that. Players clearly prefer live-dealer games, so that's what we provide.

How difficult was it to build the consensus necessary to collaborate with the other provinces on the Canadian Poker Network?

A. Cousineau: Collaboration was necessary because the social games require scale, volume of players, and liquidity. Even for casino games that do not require liquidity, the consumer still expects to find a broad product offering when it joins in a site. Collaboration is really the best, and probably the only, way to meet consumer expectations. In the end, we need to provide a broad platform of all the games, and the scale to compete in the social gaming space, like poker. In order to accelerate the process, we made the conscious choice of not reinventing the wheel, not developing our own products, but using those products that are out there, proven to be successful, and can be efficiently integrated into our network platform. We will have the entire range of casino-style games, poker, bingo, sports-betting, and lottery games.

Scaling up in the social games is a challenge. Poker Stars has had up to 240,000 players worldwide playing at the same time. Since our access, by law, is restricted to players in Quebec and these of other Canadian provinces that have agreed to participate (only BCLC for the time being), the most we have had is 3,000 Quebecers playing at one time. We have to get the number of active players up to compete with the alternatives, even though they are not legal in Quebec.

Why don't you do what the United States did and kick them out?

A. Cousineau: That is a political decision which is not made by us. We do need to find a way to overcome that differential between us and the underground market. Keep in mind, though, that the U.S. actions to indict the illegals was a complex affair and was the result of more than three or four years work.

Similar dynamic happened in France, where the 'gray' market operators were licensed to operate legally. They just ported their illegally ac-

quired customer base over to the newly licensed sites. Now the operators that were complying with the law all along, like the state operator la Française des Jeux, are having a challenging time clawing market share away from them.

A. Cousineau: That's it. And it will happen again and again unless there is the realization that all the lottery operators have to join forces in order to create the scale and liquidity necessary to compete. The Canadian Poker Network is a good start. In the U.S., the challenge is even more pressing, because the casino operators are going to be strong players in the Internet space. If the lotteries come online with just lottery products, I do not think that will work. You really need to have a broad gaming platform – that's what the consumer wants and expects. And you need to have major scale for the social gaming products like poker. We expected poker to be the main revenue generator and it's not. And the reason, we think, is that it's all about liquidity.

On hindsight, is there anything else of particular import that you would have either done differently or that you think should be pointed out to your colleagues in the United States who are figuring out now how to enter the Internet gaming market?

A. Cousineau: Just that the contenders for the Internet gaming business are formidable. They are big, well-funded, and very sophisticated operators. PokerStars budget just for hiring celebrity poker players to be their spokes-persons probably exceeds our entire annual marketing budget. The same could be said about Caesars Entertainment and the other commercial operators.

Scale and liquidity are critical and extensive collaboration is, as far as I can tell, the only way to get it. Collaboration is also the only way to build the kind of strategic approach to marketing and operational efficiencies that will be an essential component to success. And international collaboration is very do-able. Euro-millions in Europe is one example, the impending World-Game another. We should explore additional opportunities to collaborate because that could ultimately be a decisive competitive advantage that lotteries have over 'gray' market operators. ♦