



Carole **HEDINGER**

Executive Director, New Jersey Lottery

The Private-Public Partnership in Action

PGRI Introduction: It has been three years since the state of New Jersey entered into a 15-year contract with Northstar New Jersey, a joint venture consisting of GTECH (now IGT) and Scientific Games. The goal is to enlist the resources and capabilities of private enterprise to drive responsible growth and optimize operations in the New Jersey State Lottery. In Fiscal Year 2016, the Lottery grossed \$3.2 billion in sales, contributing \$980 million to the State in support of its beneficiaries.

The New Jersey Lottery also implements industry best practices as defined by the World Lottery Association (WLA) in its Responsible Gaming Framework (RGF). In September 2012, the Lottery received its Level I Responsible Gaming Framework Certificate of Accreditation. In 2015, the Lottery achieved the WLA Level II and Level III Responsible Gaming Framework Certificates of Accreditation. Only five other Lot-

teries in the nation have achieved the Level III Certification. The Lottery continues to work with its partner, Northstar New Jersey Lottery, to make advances toward attaining the highest responsible gaming recognition offered in the industry by achieving the WLA Level IV Certificate of Accreditation.

Carole Hedinger served as deputy director of the New Jersey Lottery between 1994 and 2003 before being appointed acting director in 2003. She left that position in 2004 to assume the role of Chief Clerk at the Ocean County Surrogate Court where she served until June of 2010. That is when Carole was again appointed to lead the New Jersey Lottery where she continues to serve as Executive Director. The last three years have been a period of major changes for the New Jersey Lottery as they spearhead the implementation of an entirely new model for optimizing performance at a state government lottery: the private-public partnership.

Paul Jason: *How does your background, academic training, and experience as a CPA inform your approach to the way you think of business strategy and objectives?*

Carole Hedinger: I think that my background in public accounting is an excellent basis for managing a lottery organization for optimal financial performance, for both short-term profit maximization and for long-term sustainability. For instance, the focus of an accountant is go-

ing to be more on preserving margins than maximizing sales. To our minds, that not only optimizes short-term net funding, it is also a vital key to optimizing long-term sustainability and responsible gaming. That may seem obvious, but there is a lot of pressure on everyone to increase sales by enhancing the value proposition to the players by increasing payout percentages and price points. A case could probably be made for the efficacy of that

as a strategy to increase short term sales. To be sure, it may even increase short-term net. But, to my mind, the degree to which it may increase short-term net is greatly off-set by the impact it has on the profit model going forward. Typically, players quickly realize when you increase the prize-payout percentage which creates a demand for higher and higher prize payouts. That creates a slippery slope. By increasing prize-payouts, we are train-

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ing them to look for value in that specific feature. Like Sears trained its customers to wait for sales promotions to buy its products. You go down that path of training the players to expect higher prize-payout percentages and then you are under even more pressure to continue to increase that prize-payout percentage. And your costs increase because you need the infrastructure to support the higher sales required to maintain a net that is based on decreasing margins. Why do that? I would rather generate \$980 million net on \$3 billion in sales than \$1 billion net on \$5 billion in sales. The higher margin model is a more efficient use of resources, a more responsible model for player protection against over-spending, and it is a more sustainable model going forward for future generations. During the recent recession, instant games with high price points and high prize payouts were the first to decline in sales leaving lotteries dependent on them for revenue in a quandary. Prize payouts and price points are just one part of an overall strategy for growing our business.

Your experience as a CPA seems to have instilled a good instinct for the way real-world entrepreneurs assess pricing and business-model strategies.

C. Hedinger: I think so. I spent a large part of my career working with all sizes and shapes of businesses, from small businesses right up to large publicly traded companies, and this is the way they think about how to build a sustainable enterprise. These same fundamental market-place dynamics apply to the Lottery just as they do to commercial private-enterprise businesses.

Of course, it takes a variety of functional disciplines to make a business successful. Marketing, operations, sales, logistics, product development, and other areas are indispensable components to all business,

and especially for larger businesses like a state lottery. I appreciate and respect that. But in the end, our mission is to maximize revenues for our good causes, prioritize responsible gaming for the protection of the consumer, and to operate responsibly from a financial management perspective. None of those objectives is about maximizing sales. It's about maximizing business efficiencies, management discipline, and net proceeds for the beneficiaries of lottery funding.

In FY2015, you even over-shot the mandate of 30% net to return to the state by 2 points. I would observe, though, that sales of the New Jersey Lottery have also increased every year since 2008, surpassing the \$3 billion milestone in FY2015.

C. Hedinger: A business with a high margin like Lottery depends on an increase in sales. So we do need to keep our focus on the top line as well. We do that by meeting the needs of the consumer, producing great games, promoting them effectively, and doing all the things necessary to drive sales growth like good customer service and supporting our retailers.

Responsible Gaming is also a top priority for us. To that end, we want to fulfill our financial obligations to the state without compromising our commitment to provide a form of recreational gaming that is entertaining and fun. Insofar as the prize-payouts keep climbing, there is a point at which Lottery begins to resemble the play-style of slot machines. What is the difference between Instant games that pay out over 80% and slot machines that pay out 85%? We do not want to encourage a gambling mentality when it comes to the state Lottery.

In past conversations, and in my observations of your comments on panel discussions, I have always been impressed by your approach towards innovation. I would have expected a

more conservative, risk-averse approach than you seem to apply.

C. Hedinger: I think we should all be risk-averse! Risk is something we want to do everything possible to minimize. I think most lottery directors are bemused when we read current biz-lit that admonishes us to be willing to make mistakes because that is the only way to innovate and grow, etc. I can only speak for myself, but we put a very high priority on avoiding mistakes and make no apologies for that!

That said, it can also be a mistake to not assume some calculated measure of risk to make the necessary changes to keep up with changes in the market-place. The risk-assessment model applied by state government lotteries is going to be more conservative than those applied by start-up tech companies. In fact, state Lotteries will be more conservative than almost all sectors of private enterprise. And that is as it should be. We are the shepherds of a multi-billion dollar brand that is owned by the people of this state. Our first priority is to preserve the value of that brand for future generations. It is not to maximize short-term profits for the benefit of private shareholders who may have a bigger appetite for risk than a state government has. And consider the aspect in which the value of that brand is almost all tied to intangible assets like trust, integrity, and reputation. The value of those assets is in the billions of dollars. And it is ephemeral, very vulnerable to dramatic devaluation with even small miss-steps. Are we risk-averse when it comes to managing the value of those assets? You bet we are.

However, we have never been averse to taking calculated risks. New Jersey has done a lot of "firsts:" first to introduce a computerized game—Pick-it, first to go online using terminals allowing players to select their own numbers—an event that revolutionized the industry, first to use LOLA—Lottery On-Line Ticket Accounting System, first to offer a second-chance drawing with the MDI-licensed Elvis™ instant game, first to offer "Cyber Slingo®" a scratch game with an internet play component, first to Livestream drawings and first to Livestream a live lottery event.

I am averse to risk but that doesn't mean I am averse to progress. There is a risk posed by failing to act to modernize our business practices. A prudent assessment of costs and benefits often leads to the conclusion that it is indeed much riskier to stick with obsolete practices than it is to invest in change and innovation. I believe that is the case when it comes to creating the IT infrastructure that enables us to communicate seamlessly between ourselves and with our retail channel partners.

the basic structure. I'm eager to see what recommendations we receive regarding the structure of our organizations.

The New Jersey Lottery contracted with Northstar New Jersey almost three years ago. What are some of the outcomes of this change?

C. Hedinger: I am extremely proud of having been part of the implementation of this unique public-private partnership. The implementation has gone very smoothly. The purpose of the contract was to bring in the human, technological, and economic resources of a world-class commercial partner. And that is exactly what we have done. The NJ Lottery has retained total authority and control over every aspect of the operation, only now it is with the benefit of a partnership that augments our operation in ways that we could never have otherwise done.

State lotteries all operate with budgets that are not well synchronized with the business model. Budgets are not based on optimizing ROI of expenditures and the potential of a market-driven business. We now have a partner who is capable of applying that kind of analyses to investing in the business. They can invest in growth opportunities. They can reassess the ROI and increase or decrease investment as needed. They have more flexibility to make changes as needed, to invest in new technology, new merchandising and retailer support programs, to test new games or promotions, to increase the sales force and implement sales force automation tools, to make personnel changes, to enter into third-party relationships and other initiatives that promise to improve performance and results. Northstar has the flexibility and the resources to maximize the potential of the business. And we retain control to ensure that everything is performed to the highest standards in every respect.

Now, together we can build three to five year business plans and know that the resources will be allocated to support those plans. The outcome is year-over-year growth. Most importantly, the entire enterprise is being positioned for long-term sustainable growth. We exceeded \$3 billion

But for instance, at PGRI's last conference in NYC, you articulated a compelling argument for state lotteries to work together to overcome obstacles to the implementation of forward-looking IT like Application Programming Interface.

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Your assessment of the advisability of any investment, including innovation where the outcomes are uncertain, is calculated by a relatively straightforward assessment of financial costs and benefits. But how do we do that when there is no way to ascertain the costs and benefits?

C. Hedinger: The accounting profession certainly tries to integrate all the facts, including those which may not have a concrete financial metric to attach to it. We just try to mitigate the influence of fear of loss and hope of gain that are not based in fact. Accountants are among the most trusted advisors to businesses because we really do wrestle with all the pressures

posed by a challenging business environment. We respect the fact that the future is uncertain, and that inputs to help us discern the correct actions are not always quantifiable. We still insist on the importance of cost-benefit ratios and the need to assign values to factors that are not wholly quantifiable. In the end, you have to rely on your experience, judgment, and the facts you have to make a decision

U.S. lotteries are served by three organizations, NASPL, MUSL, and Mega Millions. There is an effort to explore the potential to re-structure the organizations to improve productivity, efficiencies, and outcomes. Do you have an opinion on whether or how the structure should be changed?

C. Hedinger: I am not sure that the structure is either broken or needs changing. NASPL serves the function of a trade association, being a clearinghouse for information, publishing a trade magazine, and coordinating educational seminars and trade shows. I do not think a trade association should dilute its focus by performing tasks that a commercial enterprise is better equipped to perform. Likewise, MUSL and Mega Millions develop and manage games and they should stick with their core competencies. I'm sure there is always room for improvement, but I'm not sure that the basic structure needs to be changed. I'm not even sure what we think we would accomplish by changing

in sales in fiscal 2015 and exceeded last year sales a month early in FY 2016.

What is an example of something that has been accomplished that would not have been done without your partnership with Northstar?

C. Hedinger: Anything that requires capital investment is a problem for state lotteries. The ROI on investment may be very positive, but if it is not in our budget it's difficult to fund. Northstar is not constrained in that way. For instance, Wawa is a large multi-state corporate account with more than 240 stores in New Jersey alone. But they would not sell Lottery in

New Jersey Lottery would ever have gotten into Wawa without Northstar.

Automating the sales force involved an investment that the Lottery was not able to do. Theoretically, there are many things that could be accomplished by the state Lottery without entering into a private-public partnership. But there are three things about that. First, state budgeting and management procedures are just not conducive to operating in a market-driven business environment. As far as I can tell, that is true for all state lotteries, not just New Jersey. Second, a private enterprise like Northstar is better

C. Hedinger: We have. We are two separate entities, but we operate as one integrated organization. For one thing, every aspect of execution involves both the Lottery and Northstar. If Northstar is going to run a promotion, my finance people need to know about it because we have to account for it, reconcile commissions and record other aspects of every initiative that takes place. For another, I insist on a spirit of mutually supportive collaboration. There is no "us" and "them." We clarify objectives and then we work as a team to accomplish our common goals. Northstar appreciates our

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a clerk-assisted mode. They would only sell Lottery in their stores if we installed self-service vending machines. The NJ Lottery could not allocate the funds for those machines along with the development of the back-office reporting that they required. Northstar installed the machines, developed an accounting system to meet their needs, and Wawa is now our largest retail account. I don't think the

at doing many of these things, like negotiating a multi-state deal with Wawa. Third, the private-public partnership effectively outsources the risk of investment and future-proofs the Lottery against ill-advised investment.

It sounds like you have engineered a very collaborative approach with Northstar New Jersey.

deep involvement because it maximizes the likelihood of success. And we appreciate Northstar's commitment to align not just with the big-picture financial targets, but with every aspect of execution to achieve those goals, with our methods of operation and our culture, and our need for accountability on details of implementation as well as outcomes. ■