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PGRI Introduction: This has been an eventful year for the lottery industry and for Scientific Games. Changes are taking place across the industry and progress is happening worldwide that promises to change the face of government lotteries. In this discussion with Jim Kennedy, the changes are all about consolidation, convergence and content. The result of these changes is creation of scale and a cross-jurisdictional business model that helps position government lotteries for a successful future by keeping pace with shifting consumer needs and maximizing access to best distribution partners.



Paul Jason, Public Gaming: *What exactly is meant by consolidation? Who and what is consolidating in our industry and for what purpose?*

Jim Kennedy: Consolidation is simply a natural phase that drives the economic system across all industries. It is driven by economics—the drive of companies to succeed by positioning themselves to produce and deliver better products at efficient prices. The consolidation of independent retail stores into multi-state operations, for instance, is producing an improved consumer shopping experience, more efficient operations and lower prices for the consumer. It is simply more efficient, effective and profitable to operate as a cross-jurisdictional retail organization, and it enables the enterprise to offer products and services at a higher quality and greater value on a more consistent basis and in a more cost-effective way. Another example of this can be seen in the consolidation of media companies, which enables the integration of nationwide multimedia campaigns so that they are more impactful while drastically reducing the cost per consumer impression.

The consolidation independently taking place in the lottery industry and the gaming industry—and in these two industries together—should result in better game content being delivered through multiple channels of distribution, media and consumer points of access. Combining and integrating corporate assets via mergers and acquisitions enhances the ability of the modern enterprise to compete, deliver shareholder value and create unique customer value. The success of Scientific Games lies in our ability to deliver the best products and services—and the best value—to our customers.

Independent from one another, Scientific Games, WMS and Bally are all world-class businesses, supplying excellent products and services to the gaming and lottery in-

dustry. Why should they all be brought under the one corporate umbrella? Who benefits and why?

J. Kennedy: We completed our acquisition of WMS late in 2013 and we are now almost at the one-year mark of our business integration. On August 1, 2014, Scientific Games entered into a definitive agreement to acquire Bally Technologies, Inc. Certainly, we have already seen the benefits from our integration with WMS. Our customers benefit, our shareholders benefit and the consumer benefits. Scientific Games succeeds when we enable our government lottery customers to increase sales, market share and net profit performance. That goal is achieved by enhancing the products and services we provide. In our Lottery Group, our direct customer is the government lottery operator. But our games are delivered to and purchased by consumers. Combining game content, delivery systems, technologies and all of our resources under one corporate umbrella greatly enhances the ability of every one of our customers to connect with their consumer, the player.

The mission of an individual state lottery is largely to build its share of a targeted market of traditional lottery players by marketing and selling through traditional channels. Even within this context, there's a lot of room to innovate lottery games and to expand the retail footprint—and Scientific Games is more focused than ever on advancing this plan for our customers. For many, though, the long-term business plan will be to expand into new games, new channels and new demographic markets. Our goal is to innovate for our customers and create the best game content and marketing programs to reach consumers across multiple distribution channels. We bring together an industry-leading portfolio of game content, game development, distribution networks, insights and technology resources. Each customer we serve in every jurisdiction will benefit by the depth and breadth of having this entire portfolio of capabilities all under one roof.

The common thread behind consolidation is cross-jurisdictional reach. That applies to our industry just as it does to all others. We may think of the lottery marketplace as being defined by the borders of a juris-

diction, state or province. But the modern digital-age consumer does not think this way. Multi-state retailers do not think this way. The media companies that are a part of the firmament of all powerhouse consumer brands do not think this way. And for all lottery operators, future success will involve working together with other jurisdictional operators to build national brands as well as the multi-national distributional, media and promotional strategies that drive the success of those brands. The integration with WMS has given us improved scale, diversity of capabilities and cross-jurisdictional reach in ways that help our customers optimize their business plans—and not just now but into a future filled with new opportunities and competitive challenges.

You said that it is the convergence in the consumer marketplace that is driving supply-side industry consolidation. How is consumer behavior changing? More specifically, how is the behavior of the recreational gamer and lottery player changing?

J. Kennedy: Gaming options for the consumer have become available everywhere, through all varieties of distribution channels and venues. The notion that the lottery player doesn't play other games of chance may have been true when they had to get on an airplane to go to a casino. But that's no longer true. Now, well over a third of the population of the United States lives within 25 miles of a casino. And research is mounting that indicates the cross-over between lottery and casino play, going both ways, is increasing every day.

The modern consumer enjoys variety and is much more willing than past generations to experiment with new forms of recreational gaming. Their willingness to adopt new devices and services, and to try new shopping and entertainment options, is completely reshaping the consumer marketplace. This appetite for what's new, different and innovative will apply to recreational gaming as well. The modern consumer may not even go into c-stores, or be satisfied with a limited network of land-based retailers where they can buy lottery games. This is especially true for the younger demographic who grew up in the digital age of non-stop change and fresh alternatives to stimulate their interest and engagement on a personal level.

The consolidation of operations to address these trends is happening on the con-

tent side—the consumer wants to have the option to play different games. And it's happening on the distribution side—the consumer wants the option of self-serve systems, to buy and engage via the internet, and to buy in all varieties of storefront locations including restaurants, financial institutions, as well as at Costco, Wawa, Walmart, Walgreens and all the other big-box retailers. C-stores will always be a major channel for lottery products. However, even they are consolidating or being absorbed by large chain operators.

Again, we are clearly seeing consolidation happening on the media side as well. Lotteries have collaborated with each other to take full advantage of this media consolidation—delivering promotional information over the internet and other media, integrating with TV game shows that feature lottery winners, and potentially collaborating with the brand, messaging and promotional strategies of other consumer brands. This is smart customer marketing using today's best strategies.

It is partly a chicken before the egg scenario. Marketers must adapt to trends in consumer behavior. But the trends will gain momentum as consumers adapt to advances in consumer marketing. As the industry consolidates and as companies like Scientific Games make it easier and easier for the consumer to access multiple varieties of games from more and more consumer access points, this will drive further consumer migration among game categories and distributional channels. This may sound like a mixed blessing if a company thinks that it has a monopoly over consumer behavior. But there are three things to consider. First, making life easier and more convenient for the consumer is never a bad thing, especially if you are the first-mover and stay close to the consumer. Second, delivering more and better game content along with easier access for the consumer to buy the product will absolutely expand the market. And third, operators, traditional retailers and suppliers don't really have a choice. It is the consumer who ultimately decides. The marketers who give consumers what they want—ideally, anticipating what they will want and making sure it is already there waiting for them—will succeed. Any strategy based on offering the consumer access to lottery products at a limited variety of access points will result in lost market share, declining sales and declining net returns to good causes.

Why is consolidation a positive thing for those government lotteries that focus on traditional lottery products and aren't necessarily interested in the digital realm and iLottery games?

J. Kennedy: Consolidation is a positive thing for government lotteries because it offers a more efficient system for creating and delivering the games consumers want and making the games available where and when players want to play. Lotteries already have scale in the one area that all businesses strive hardest to achieve—they have lots of customers. It is more important than ever—and especially so for the lottery operator that focuses on traditional lottery games sold through land-based retail stores—to enhance the consumer connection, to maximize the brand power of lottery and create relationships with players, and to turn anonymous consumers into loyal, repeat customers. Consolidation is strengthening the important area of consumer insights which in turn informs a lottery's marketing strategy to be relevant with its consumers.

It does seem like everyone agrees on the importance of building national brands. That would seem to mean that state lotteries need to integrate a cross-jurisdictional approach to everything from brand messaging, to promotions, and to business processes that facilitate cross-jurisdictional distribution.

J. Kennedy: At the end of the day, consumers play games, whether they are Powerball® games, Jumbo Bucks instant games or the new MONOPOLY Millionaires' Club™ national game. We are looking at how game content can be shared and leveraged from one category to another across all industry sectors. Along with our WMS colleagues, we are researching consumer behavior as it manifests differently in various regional and state markets, across game categories like lottery and electronic games, and across different gaming venues and points of consumer access like retail stores, internet, casinos, self-serve, etc. We've learned that the appeal of different game concepts and popular licensed properties bridges game categories. The content is shareable across all categories. Scientific Games is now in a position to introduce concepts that are successful in the electronic games environment to the lottery player, and vice-versa. And even with the addition of all the game content and capabilities of WMS, we are very open to col-

laboration with third-party companies when it best serves our customers.

Are you responsible for integration of all lottery functions?

J. Kennedy: We are now in the process of fully integrating our global lottery business at Scientific Games. This includes our systems business, our MDI licensed properties and promotional marketing, our instant products business and our interactive business. Going through this process has shown us so many opportunities where we can best partner with our customers to deliver innovation, creativity and operational excellence. Working together in a single organization that's solely focused on lottery and our global lottery customers has been one of the most professionally rewarding experiences of my career. I am proud of this industry, proud of our customers and proud of the talent at Scientific Games.

There seems to be intractable obstacles to cross-jurisdictional distribution of lottery products. That is, making lottery business processes acceptable for multi-state retailers.

J. Kennedy: Multi-state retail operations are horizontally integrated. Efficiency and streamlined logistics are cornerstones to their business model. Placing product and technologies into a large retail chain like Walmart, Dunkin' Donuts or Walgreens with 37 different requirements from 37 different lotteries does not and will not work. It is a barrier to entry. It just does not work for the retailer because they want to deal with a single supplier, or at least a common system for accounts receivable, a common set of metrics, standardized report formats, and uniform sets of business practices on every level. A very practical reason that lotteries aren't growing in their distribution footprint is that distribution has become far more horizontally integrated than their jurisdictionally bound business processes.

I'm going to tie this back again to the media industry because I see many parallels. It is no longer just about TV commercials and billboards. Consumers of social media and other forms of non-broadcast media are far more horizontally integrated across multiple platforms. Like land-based retail, media is expanding horizontally to adapt to the convergence of the consumer market into all forms of new media. Players clubs, loyalty programs and 2nd Chance drawings

are just beginning to tap the potential of a multi-media, multi-platform approach. The national TV game show and other promotional strategies being applied to MONOPOLY Millionaires' Club will take us further in the right direction.

MONOPOLY Millionaires' Club took years to come to fruition. What can Lottery do to put these great ideas onto a faster track from concept to implementation?

J. Kennedy: Create a path for everyone to leverage their expertise, their specific core competencies, for the benefit of the industry. Creating a national premium game that resulted in MONOPOLY Millionaires' Club was a tremendous learning experience for everyone. And it ultimately came down to doing what has always worked well for lotteries and for the industry. Lotteries have demonstrated a great capacity to come together to evaluate proposals and sort out an action-plan to implement successfully. It was actually less than a year ago that the request was issued that specified what was wanted, inviting the commercial industry to respond with creative solutions. These solutions were evaluated and we were all given our marching orders. That's a pretty good turnaround time.

Still, a business with net margins of 25% to 30% should be able to fund even more innovation, more vigorous game development, more initiatives that would meet the needs of cross-jurisdictional retail operations, and fund initiatives to penetrate completely new retail sectors. With an ROI on investment being so high and so predictable, why is it so hard to get funding? For instance, why couldn't you, the commercial community, fund it and be paid from future profits?

J. Kennedy: I have been trying to solve that puzzle for 20 years. The process of deciding on and implementing MONOPOLY Millionaires' Club will hopefully provide some answers and open some doors. Put out a request for getting something done across jurisdictions and invite the supply-side to respond. I do think the industry is evolving to respond to the needs of a marketplace that is more and more horizontal and cross-jurisdictional.

The U.S. lottery industry is a \$70 billion consumer category. There is an enormous amount of marketing and consumer product presence that can be brought to bear if

we see ourselves as a \$70 billion product category instead of a fragmented collection of smaller markets. MONOPOLY Millionaires' Club could be the breakthrough product that lets the lottery industry see itself as a national force instead of an affiliation of individual jurisdictions.

Why is it so important to have a national presence when each lottery actually only sells within its own borders?

J. Kennedy: One of the persistent challenges that we face in our industry is growth in playership and growth in retail touch-points. Those have been the two limiting factors in our business. By creating a national presence that has the ability to leverage the dynamism of a fully integrated, nationwide marketing and promotional campaign built upon a consistent brand messaging strategy, lottery will become much more attractive to a broader population. This scale enables the funding for more creative game development, higher-impact marketing, and the resources to overcome obstacles to cross-jurisdictional retail sales. It will change the way that lotteries perceive themselves, how consumers perceive the lottery industry, and how retailers perceive the lottery industry. That shift is going to translate into more people playing—and more retailers and distribution partners wanting to be associated with the good causes that lotteries support.

I keep coming back to the word "scale." We get scale now—nationwide consumer buzz and engagement—when we have a big Powerball or Mega Millions® jackpot and the media jumps in to help us brand and promote it. But we as an industry are not actually creating scale; we are waiting for scale to happen. And as we have seen, this leaves us very vulnerable to changes in consumer expectations and the willingness of media to perform its part to help us promote jackpots. Why can't we have that level of consumer buzz all the time? Lottery as a whole needs to be proactive at creating that scale itself, at engaging the level of consumer interest on an ongoing basis that we now only see when the jackpot exceeds hundreds of millions of dollars. The successful consumer marketing powerhouses don't wait for consumer engagement to happen. They take control and create it for themselves. This is our opportunity, and I'm excited to see our collective industry leadership embrace this positive change. ♦