



## Martin Kon

Partner, Oliver Wyman Group (left)

## Tim Matusch

Associate Partner, Oliver Wyman Group (right)

We recently talked with the Acting Superintendent of the Illinois Lottery, Jodie Winnett, about the initiative to outsource the management of the Illinois Lottery. An important idea that was emphasized in that interview (appeared in our June issue) is that this is not a “privatization”: the State of Illinois will retain ownership, exercise actual control, and have active engagement in terms of the operational parameters of the Lottery.

Oliver Wyman is the international consulting firm that has been retained to act as Transaction Advisor to the State as they select and implement a Private Manager for their Lottery operations. The work has involved valuing the asset under multiple future scenarios, working with a broad stakeholder group and legal advisors to craft and release the contract between the State and Private Manager, and preparing and managing the RFP process. Martin Kon is the Partner leading Oliver Wyman’s support of this initiative, and Tim Matusch is the Associate Partner managing the team on the ground.

In some respects, this initiative seems similar to the ways in which U.S. states already outsource many aspects of operating their Lotteries. But Martin and Tim clarify how the Illinois approach is different from what other lotteries are currently doing and also explain the role of Oliver Wyman in the process.

**Paul Jason, Public Gaming:** *Oliver Wyman is owned by Marsh & McLennan, the professional services and insurance giant. After bringing together a number of consulting businesses over the past 5 years, you have become a global consulting powerhouse. What has driven this incredibly rapid expansion? How does size and international scope enhance value to your clients?*

**Martin Kon:** Oliver Wyman is a \$1.3b international management consulting firm and one of the fastest growing of the industry’s top 10 over the past several years. Our history of strong organic growth and selective acquisition has

been driven by three objectives: enhancing our ability to serve clients, offering deeper industry and functional specialization, and serving clients seamlessly across borders. Our clients’ problems are highly specific, and generic solutions simply don’t deliver the impact needed. Oliver Wyman made a decision to seek depth, in both select industry verticals and in important functional competencies, to bring our clients truly differentiated capabilities that complement their own. In addition, our clients’ businesses are increasingly global, and they tell us that perspectives and experience from analogous situations around the world is of great value to them, even if their own operations are focused on local markets. We operate in 40 offices in 16 countries and often bring together multinational teams to address client problems.

*How does the size and depth of Oliver Wyman contribute to your ability to perform specifically on the Illinois Lottery assignment?*

**M. Kon:** The opportunity that Illinois is addressing is high-stakes and complicated, and as such requires expertise and experience in a number of areas. We are able to bring together professionals with deep expertise both in the lottery & gaming sector around the globe and with public-private partnerships across multiple sectors. Our team supporting Illinois is comprised of individuals who have direct experience with leading lottery operators in the US, Canada, and Europe, and who have managed dozens of successful transactions in the public-private partnership

arena. Additionally, we can call upon a network of colleagues from around the globe for specific perspectives or insights that could be valuable to the process. At the same time, Oliver Wyman Group has been a part of the Illinois business community for more than 20 years, with more than 100 employees in our local office in Chicago.

*Oliver Wyman has quite extensive and impressive experience in a wide variety of industries. What, though, is your experience with the lottery and/or gaming business? What experience, knowledge, competencies, internal resources and capabilities recommend Oliver Wyman for this assignment of being the consultant leading this Illinois Lottery initiative?*

**Tim Matusch:** Our real value-add, and a core part of our proposal to the State when they were selecting their Transaction Advisor, is our ability to bring together cross-functional teams with expertise in many different areas. Oliver Wyman has served the broad lottery & gaming sector for over 10 years, including some highly progressive markets in other countries. We have been working with many leading operators to achieve significant improvements in both revenue growth and profitability across the value chain. This work has included brand strategy and new product launches, pricing and promotions, distribution channel redesign, customer engagement and loyalty, marketing effectiveness, labor productivity and procurement, as well as regulation, compliance, and responsible gaming. What that means is that we understand best practices from the leading operators in the world, how to

maximize the value of a lottery franchise, and how potential bidders might themselves look at an opportunity like the one here in Illinois. This sector knowledge, in combination with our extensive experience with Public-Private Partnership deals, as well as other relevant State / Private Operator transaction structures and processes, means that we can help Illinois realize an optimal outcome.

**M. Kon:** This is a highly visible and highly sensitive transaction for the State, especially given the sector. Process integrity, the highest ethical standards, and probity assurance of bidders are of utmost importance. As such, we added our partner firm Kroll Associates to our team to conduct probity investigations of bidders, leveraging its global network of investigators to uncover any relevant issues that might be potentially of interest to the State. Additionally, we created a specific role of 'Chief Process Integrity Officer' for one of Kroll's managing directors, a former Assistant United States Attorney who has earned public commendations from the FBI, the US Secret Service, and the Department of Justice. We felt that a crucial part of our value proposition to the State was to ensure a completely ethical and fair process, backed up by someone with unquestionable credentials.

*Is there anything you can tell us about the process going forward? Do you prepare some kind of "white paper" that analyzes the operations and performance of other lotteries as a way to provide context for exploring opportunities to improve the Illinois Lottery? Do you perform meta-analyses on the lottery and gaming industries to see how to position the Lottery for optimal long-term success?*

**T. Matusch:** One of the first exercises was to build a comprehensive perspective on value creation opportunities for the Illinois Lottery. That comprised a full international review of lottery and gaming operators, best-practice insights and benchmarks from relevant out-of-industry analogues, as well as a detailed appraisal of current Illinois Lottery strategy and operations. The primary objective of this exercise was to understand the potential future overall value of the Lottery, as well as the specific strategies and activities that might be required in order to drive that value growth. Ultimately, the State wanted to have a clear idea of the potential value of their asset to ensure that they can structure an optimal deal and drive maximum value creation for the State. Subsequently, an inclusive and iterative process integrating input from a broad stakeholder group, the entities who registered themselves as Interested Parties, and an experienced Legal Team, yielded the contract between the Private Manager and the State: the Private Manager Agreement (PMA). Some of the biggest chal-

lenges we have faced have dealt with finding the right balance between State control and a reasonable operating environment for the Private Manager, especially with respect to scope, governance, and incentivization. The formal RFP process, where Interested Parties received relevant information to help determine their bidding decisions and bid preparation, has been run in parallel to comply with the tight timeline laid out by the Illinois State Legislature. Finalists' bids were due on September 3rd, and after a Public Hearing and committee evaluation, the Governor is set to announce the winner on September 15th.

*Other lotteries already outsource large portions of their operations. Typically, the online "lotto" side of the businesses is contracted to one vendor and the instant scratch-offs to other vendors. I am thinking that the defining characteristic of this Illinois initiative is that instead of creating multiple contracts with various vendors and then managing those contracts with a relatively smaller team of state employees, you will combine all these functions so that one commercial partner is responsible for implementing all aspects of the business, from online to instants to advertising and HR, IT and all other aspects of operating the Lottery. Is that correct and can you clarify this?*

**T. Matusch:** You're right that one of the key benefits in this transaction is that a single commercial partner is responsible for implementing all aspects of the business. We see significant strategic gains in having a Private Manager with deep operator-side knowledge and experience have a complete view over all aspects of the business. No doubt they will look to streamline some areas as well as grow others. The ability to make 'holistic' decisions will enable both efficiency and effectiveness gains to be made. How they choose to structure their operations, however, is flexible. We've taken great care in drafting both the RFP and the PMA to ensure that no one particular structure is necessarily considered preferable - we want to leave that to be proposed by the Private Manager based on their own experience and expertise. And we might expect some Interested Parties to continue to subcontract operations and others to look to consolidate operations. So the transaction allows for both 'unbundled' as well as 'bundled' structures. We will not, of course, mention any specifics of comments made by Interested Parties through this process, but it would be fair to say that many different options have been taken under consideration.

*So much of the earning potential of the Lottery is determined by regulatory constraints. Legislation enabling expansion into new games (like high-speed keno) and new channels (like Internet) would have dramatic impact on revenues and profits. Does Oli-*

*ver Wyman assist in the process of promoting this enabling legislation?*

**M. Kon:** It's important to make clear that we are a strategy and operations consulting firm and not a lobbyist, so we play no direct part in influencing legislation ourselves. However, what we can do is lay out potential alternatives to current legislation based on external analogues, and put a value, in dollar terms, of their potential impact. Indeed, when we built up the initial valuation perspective of the Illinois Lottery, we ran scenarios that conform to current legislation, as well as a number of others which incorporated potential future changes to scope of products and services offered. Our role is to provide the information and insights to our clients that enable them to make the best decisions possible.

*Outsourcing the management of the Lottery might be expected to result in a higher level of entrepreneurial and creative energy. Is that one of the objectives? State employees would contend, though, that given the same latitude and flexibility as a Private Manager would have, they would achieve the same or better results. How is the culture of business potentially different from the culture of state government?*

**T. Matusch:** The Illinois Lottery has very talented management and employees, and they've done a great job of running the Lottery under its current structure and parameters - and those include both Federal and State Lottery legislation and policy as well as broader operating and employment legislation and policy. As we helped draft the PMA for this transaction, one of our key objectives was to provide flexibility on a number of dimensions to enable the most effective and efficient operation of the Lottery. It goes without saying that simply removing constraints would allow the current team greater latitude and flexibility. But the Private Manager will also bring a new culture of innovation, talent management, incentivization, best-practices from other jurisdictions, etc., which will reinvigorate the entire business. One way to look at this transaction, and its enabling legislation, is that it represents a 'reset' of the Lottery - a new structure, a new management team, a new culture, a new incentive scheme, and a new set of parameters - all to maximize the overall value of this important asset and the returns to good causes in the State. It's very much the hope and expectation that a large proportion of current employees will continue to work within the new team, so they'll be able to leverage their talents and be part of the overall growth story. It will be an exciting opportunity for them.

*One of the rationales for why "private" industry is more effective than state government is that the profit motive is a powerful performance driver. How do*

*you ensure that the public service focus (like avoiding the temptation to make the games so stimulating that they could encourage problem gaming, for instance) is preserved along with that profit motive?*

**T. Matusch:** Profit maximization is indeed a powerful performance driver, and that's a key part of the incentivization in the deal. The higher the profit of the Lottery, and the higher the resulting compensation to the Private Manager, the greater the returns to the public causes that the Lottery supports; it's a win-win situation. But social responsibility is of special significance in the lottery industry, and the notion of responsible gaming has been at the heart of all aspects of the process. Firstly, bidders have had to demonstrate a deep practical understanding and experience in managing the tension between profit growth and responsible gaming, showcasing specific programs that address identity/age-compliance and problem gaming, among other things. The State needs to be completely confident that the chosen Private Manager respects these constraints and abides by them. Secondly, it's critical to remember that, although the Private Manager will be the day-to-day operator of the Lottery, the State will always retain actual control over operations, and can countermand any decision proposed by the Private Manager should that be deemed necessary. So there will always be a 'dual responsibili-

ty' of sorts when it comes to protecting the public to ensure that responsible gaming is paramount.

*A state lottery is a more complex enterprise than, say, a state toll-road or waste collection system. How difficult will it be to anticipate all the various contingencies and address those in a contract? For instance, one basic conundrum of this business is that we do not want to be so successful at the business of creating exciting games and promoting those highly stimulating games that we exacerbate problem gaming. How do you measure "success" and performance when you have that kind of highly subjective criteria? And if performance expectations can't be measured or otherwise clarified in a specific and concrete way, how can they be contractually defined and agreed to?*

**M. Kon:** There are a number of tensions that we've had to address in this transaction, all of which have a bearing on 'success' in the business. We've already discussed the tension between profit growth and responsible gaming, for example. Fundamentally, however, this is about growing income to the State, which means growing the profitability of the Lottery. So in hard terms, success is defined along those lines, and the Private Manager will be incentivized to keep its closest eye on the bottom line of the business. Flexibility and adaptability—the ability to react to a dynamic marketplace—are

an important part of driving optimal bottom-line performance, and as you say, the contract needs to anticipate all the contingencies and unknowns over the coming years in order for this to be possible. The PMA lays out not simply how the Private Manager will operate today, but also the process as to how the PMA will adapt to the changing market tomorrow. If, for example, the scope of products and services that the Private Manager can offer changes, then the governance and incentivization will change accordingly. That all said, growth in profitability is only acceptable if it is accompanied by strict compliance with Federal and State legislation, as well as by respect for all other social and ethical considerations. Insofar as these can be articulated unambiguously, they will be defined clearly in the Private Manager Agreement. At the same time, some elements will always require judgment, and this is where the governance structure which dictates the relationship between State and Private Manager comes into play. These are all examples of how complex this assignment is, and why it is important to secure the right level of support to anticipate issues, structure the transaction, and manage the process! ♦