



Linh Nguyen

Acting Director, California Lottery

PGRI Introduction: The California Lottery is on quite a roll. In fiscal year ending June 30, 2011, sales increased to nearly \$3.44 billion, which represents a 13 percent increase from last fiscal year's total of \$3.04 billion. "We're excited about how far we've come in such a short period of time," Lottery Commission Chair John Mass said. "We're proud to be able to provide more than a billion dollars to education for the 11th consecutive year, but we want to do more. With great new games, promotions, and a responsible business plan, the Lottery is poised to take its sales to new highs in 2011-2012." There have been significant changes that have fueled this outstanding performance. In 2010, a bill was passed that allowed the lottery to increase prize payouts. The CA Lottery itself reinforced those legislative changes with an ambitious 3-year plan to refresh the brand, streamline operations, and integrate everything into a sustainable long-term growth strategy. It is exciting to see what Team Lottery can accomplish when given the chance!

Paul Jason, Public Gaming: What do you think were the main factors behind your recent sales growth?

Linh Nguyen: There were two main factors. One is the prize payout flexibility we received from Assembly Bill 142 sponsored by Assemblywoman Mary Hayashi and the other is the hard work and dedication of our employees in the successful implementation of our three-year business plan.

Let's start with AB 142.

L. Nguyen: We had put together the 3-year plan with the hope that we would be able to increase prize payouts. We knew the plan would help us grow sales, but we also knew that an increase in prize payouts would help us grow sales substantially more. In April 2010, we got our wish when Assembly Bill 142 was signed into law. Overnight, we went from having one of the most restrictive statutes on prize payouts to one of the most flexible. AB 142 eliminated the 34% requirement for education and replaced it with a requirement that we manage our prize payouts in a way that maximizes funding for education. It reduced our administrative expenditure cap from 16% to 13%. It also has minimum performance requirements that, if not met, would trigger the repeal of our flexibility and revert to the old formula.

Increasing the prize payout percentage im-

proves the product's value to the consumer, provides us with a powerful message that gets consumer attention, and gives us a tool to drive sales and profits. A relatively small increase in prize payout percentage can be leveraged into a much more significant increase in top-line sales. Although the increase in prize payout percentage leaves a smaller percentage to be transferred to education, the total dollars going to our beneficiary goes up. And at the end of the day, you can spend a dollar, but you can't spend a percentage. So these changes have resulted in increased funding to education and that's what our constituents care most about and the reason the Lottery was created in 1984.

That seems like well-constructed legislation, giving the lottery some flexibility to put its money where its mouth is, but then also enabling the legislature to reassert control if the performance targets were not achieved.

L. Nguyen: I think it was very well constructed in that it did not establish a specific prize payout level or profit requirement. Instead, it trusted the Lottery Commission to set prizes at a level that would maximize funding for education. The minimum performance levels in the bill effectively protect the interests of the legislature, the voters of California and stakeholders in education. At the same time, it provides the lottery with the flexibility to quickly boost

performance in the short-term and build brand equity and sustainability for the long-term.

Is there anything that you would have liked to have seen in the legislation that was not there?

L. Nguyen: Not in terms of prize payouts, because of the real flexibility it gave us. AB 142 really created a win, win, win ... win situation. Players receive more prize money and more entertainment value. Retailers receive more commission. Education receives more total lottery funding. And our organization now has the opportunity and increased motivation to improve performance across the board.

In terms of other legislative changes, I think the next hurdle for lotteries is determining their future on the internet. After all, this is where consumer shopping habits are trending and we need to be ready to meet consumer demand. For now, AB 142 enables us to serve our stakeholders well and to deliver sustained growth for the next several years. In that regard, we are in better position for growth than lotteries that have a more mature instant product.

AB142 set the stage for changes in prize structures. How did you change your approach as a result?

L. Nguyen: The first thing it allowed us to do was to keep a \$5 ticket on the street at all times. In the past we had offered a \$5 ticket maybe one or two quarters out of the year because we couldn't

afford the higher prize payout in those games. You can't put out a higher price-point ticket without giving players something in return, such as better value through a higher prize payout percentage. In fact, all states have tickets priced higher than \$5, but we really weren't able to consistently offer a \$5 ticket because of the payout restrictions. Now we have four to five \$5 tickets on the street at all times. This is a huge improvement in our product offering. It's what's driving our current sales growth. We've also increased prizes in all of our other price points as well to make all the games more appealing to players. But we make sure to wring every ounce of promotional impact out of any improved value we deliver! Having established the \$5 price point as a permanent part of our portfolio, we recently launched a \$10 ticket. In fact, we are the last state to offer a \$10 ticket so we knew based on other states' experiences the \$10 ticket would be successful.

How is the \$10 ticket performing?

L. Nguyen: It's been out for a week and has already exceeded expectations. We projected about \$7.25 million in sales for its first week, so we were happily surprised when sales shot up to \$12.5 million. It has also lifted overall instant sales. We had been averaging about \$42 million a week, but with the launch of the \$10 game we had a \$53 million week.

Is there research or evidence that measures the responsiveness of players to increases in the prize payout percentage?

L. Nguyen: In the history of the California Lottery, we've been able to significantly increase prize payouts only twice before, both times being funded by redirected cost savings. We measured the impact and saw a 7-1 return in sales, and a 2-1 return to education for every \$1 we were able to put towards prizes.

A net ROI of 100%. Spend \$1, get \$2 in return.

L. Nguyen: Right. In developing our own strategy and projections, we did not rely solely on our own limited experience. We also analyzed the more recent experience of other states. And we look carefully at all the details of promotion and implementation to ensure we optimize the long-term impact on funding to education. Long-term sustainability is a central theme to everything we do.

California may have benefited from being late to the game of higher prize payouts because we were able to learn quite a bit from the experience of other state lotteries and their best practices. For that we owe them a debt of gratitude. We were able to study the experience of others, and be counseled by others on their experience. Having the benefit of seeing the effects of different ways of going to market helped us

sharpen our approach to effectively build brand equity and consumer awareness for a more exciting Lottery. Based on our assessment of the long-term impact of different approaches, we focused on building a sustainable growth strategy. And so we didn't drastically increase prize payouts right away, by increasing the number of \$5 games followed quickly by a \$10 game even though that would have generated a higher increase in sales in the very short term. Instead, we wanted to implement the increases strategically over time so that we could maximize our return over the long term rather than just a one or two year boost followed by a leveling off period. So we established the \$5 game as a permanent part of our portfolio before introducing a \$10 game.

On the flip side though, sustainable growth doesn't mean having a low-key approach to marketing. We boosted the prize payouts of all Scratchers by three to six percentage points to provide enough added value to capture the attention of the consumer. We also dramatically increased our advertising effort against the Scratchers product – something we hadn't done in a long time. So sustainable growth strategy doesn't translate into having a conservative approach to sales and marketing. It means having a measured and calculated strategy to optimizing long-term transfers to our beneficiary. That means maximizing the ROI of every dollar spent on increased prize value and marketing. And ensuring that consumer expectations are managed such that we stay on their radar as an exciting product that delivers a great playing experience while at the same time leaving room for us to grow with our customer and continue to exceed expectations long into the future. So we're very careful about that, and I think that our sales results over the first year show that we got it right.

An important aspect of managing for sustainable growth is to recognize that prize payout is just one product attribute. We want to manage the long-term development of an entire portfolio of products and integrate the attribute of prize payout into a broader plan of building brand equity into each product, establishing some core games around which we build specific sets of product attributes, and differentiating those core games from each other. So, we want to create value for each product and each set of core games based on a variety of product attributes, only one of which is prize payout. For instance, we developed a win for life game, we called it 'Set For Life', and we established a price point with advertising and marketing and that synchronizes with the type of value that a player wants from this type of game, which is a much different profile than the player who runs out to buy lotto tickets when it reaches giant jackpot levels. We wanted to create a core game that could be

a relatively permanent part of our instant portfolio. The long-term sustainable growth approach means thinking about all the component parts of the business and the products and making sure that we can meet consumer demand and expectations now and in the future.

To what extent would you attribute your 13%+ sales increase to the flexibility you were given to manage prize payout structure?

L. Nguyen: Flexibility to manage prize payout is vital, because without it marketing can only take you so far. But even so, it is still just a part of the overall action plan that includes many other things. Without a holistic and strategic approach towards thinking of prize payout as but one part of a broad palette of product attributes and management and marketing tools, the short-term sales increase would have been less, and the long-term growth would definitely not realize its full potential. Managed improperly, increasing prize payout percentage can result in nothing more than a short-term spike in sales with a flattening out and little room to maintain ongoing growth.

The real key for us was to fundamentally change our business practices to make the most of the opportunity AB 142 provided. That's where our 3-year business plan and change management effort came into play. We called this effort the "Renew" project. At its core, the Renew Project is a renewal of our innovation, drive, and commitment to maximizing funding for California's public schools.

It was really the hard work and dedication of our staff that has made the difference. Without them, making real change is impossible.

To what extent did Camelot contribute to your success?

L. Nguyen: Getting the flexibility to manage your prize payouts comes with a new responsibility and a lot of work to make the most of it. We knew this was a huge undertaking and we leveraged all of our resources. There's the old saying that failure is an orphan and success has a thousand fathers. The truth is that we sought advice from all of our key vendors and industry experts. Our senior management team did an outstanding job of vetting all of this information to develop and implement the business plan. Our sales force did a tremendous job of focusing on the activities that truly drive sales at retail. Our sales force is the face of the lottery with our retailers and they have really risen to the occasion. My hat is off to them for their ability to focus despite the economy and state budget crisis. It is a true testament to their dedication to growing our contribution to public education.

Managing change and boosting morale were also extremely important. And the key is com-

munication. These are activities that our communications team tackled without using vendors. Employees want to know what is going on and how they can contribute. We now inform staff of our plans for the year and they receive weekly sales updates and advanced notice of advertising campaigns and significant events. We've also created opportunities for them to work as a team and interact like never before. And it's paying off. Morale and productivity are higher than I have ever seen it.

How has your Internet strategy evolved?

L. Nguyen: We're transitioning from a typical government entity website that provides information, to one that has become a core piece of our player loyalty efforts. We are launching a new website before the end of this calendar year, and are very excited about that. One of the key features of the website is our second-chance program. It's modeled after what Rebecca Hargrove implemented in Tennessee. So we're thankful to her for her help and assistance in our program, which will make our website much more valuable to our players.

But you are already ramping up quickly, aren't you?

L. Nguyen: Yes. Our second-chance programs have given away nearly \$8 million so far since May 2009. Our quarterly Replay pool draws are now attracting more than 25 million entries. And since 2009 we have had nearly 175 million Scratchers tickets entered for a 2nd chance to win. We have almost 2 million registered players, which grows at a rate of 3% a month. And now the new website includes a true loyalty rewards program where players will be awarded points for participating in various casual games for fun.

That's amazing. You are clearly doing a lot of things right. The 3% per month growth rate will level off a little at some point, won't it?

L. Nguyen: We do not think that it will. Our programs are staged to roll out with the clear objective to keep it fresh and changing. I frankly expect the growth rate to increase. The second-chance draws and loyalty programs are hugely popular with the consumer. We just need to stay connected, keep it fresh and engaging by evolving it to stay in step with changing consumer tastes and trends. And that is what we are going to do. Attrition rate for membership programs are, on average, high. The consumer loses interest quickly if the program is not constantly evolving to maintain consumer interest.

You incentivize the players to register by awarding points that can be redeemed for lottery tickets or merchandise?

L. Nguyen: Exactly. The player must register in order to enter non-winning ticket numbers into drawings. The challenge is creating awareness, in just letting more people know about the program. Right now we are only doing scratchers. Next up is to expand the second-chance program to draw games.

Well, that would be huge. A whole new group of consumers. I can see why you are confident that the 3% monthly growth rate is sustainable. Why isn't everyone implementing second-chance draws for lotto as well as scratch-offs?

L. Nguyen: It's like with any product and promotion in the lottery business. You have to decide how to best use your prize funds. The prize funds for the second-chance programs have to come from somewhere. The business has to make decisions about whether the funds are best allocated towards second-chance draws, or to fund another prize tier in a draw game, for example. But based on our experience we believe that second-chance programs are an incredibly powerful marketing tool, they result in converting the customer into a registered member, and so funding it is simply a top priority for us.

So your in-state lotto game, Super Lotto Plus, will have a second-chance program?

L. Nguyen: Yes, that is the plan. It also differentiates our in-state game from Mega Millions since they are both priced at \$1. We feel that getting our players to become registered members is one key to long-term growth, so we want our lotto players to be registered as well as our instant players.

Are you thinking of adding Powerball?

L. Nguyen: We are currently evaluating the \$2 Powerball game. We are conducting research at this time and have not made a decision regarding Powerball. Right now, we have a marketing calendar that is queued up with advertising for Scratchers, Mega Millions, a new website, and holiday promotions. We want to make sure \$2 Powerball is the right game for us, that we are able to market it properly, and that we launch at an ideal time. I think the key to a successful launch of a \$2 Powerball game is how well the game can be differentiated and marketed within our lotto portfolio. We are anxious to see how the game performs in other states. Looking at our growth curve, Scratchers are taking us to another level and we are determining whether \$2 Powerball will help us get to yet another level.

It makes sense that when Powerball was opened up to the Mega crowd that you passed on it because you already have two really strong \$1 lotto games. Now that PB is at \$2, you've got a product that is differentiated and perhaps does contribute to the

portfolio of lotto products in a way that yet another \$1 lotto wouldn't have done.

L. Nguyen: Right. For us, differentiation is the key. We learned that from the introduction of Mega Millions. The marketing strategy was to encourage players to play both Super Lotto Plus and Mega Millions. It makes sense – the addition of Mega Millions gave players another jackpot game to play on different days of the week. However, it did not play out that way. It launched well, but combined sales of the two games not only leveled off, they actually fell to a point that was below the level of Super Lotto Plus prior to Mega Millions. There was much larger cannibalization of Super Lotto and some players simply left the lotto category altogether. We are very sensitive to the need to manage an entire portfolio of products for optimal overall results. Expansion of products without a well-conceived and executed strategy can be counter-productive. At this point, we are assessing how \$2 Powerball fits into our portfolio of lotto games.

Insofar as Super Lotto has been declining, and Powerball now has a price point that is different from Mega, why not just replace Super Lotto with Powerball?

L. Nguyen: That's the question. Keep in mind that last fiscal year, Super Lotto brought in over \$430 million in sales and Mega Millions brought in over \$530 million. And so far this year, Super Lotto sales are actually ahead of Mega Millions by \$10 million because of better relative jackpots. Although Super Lotto sales have been declining, it still has substantial sales especially considering the average Super Lotto jackpot was \$15 million and the average Mega Millions jackpot was \$65 million. So jackpots aren't everything and Super Lotto has proven to have a shrinking but very loyal player base. In addition, its decline has been slowing. That's why we are putting some promotional effort behind Super Lotto by adding second chance draws and exploring other ways to differentiate it from Mega Millions. It's still the most recognized product we have.

Replacing Super Lotto with Powerball or determining how to add Powerball is a decision that could swing our sales hundreds of millions of dollars in either direction.

What are some other performance drivers that are producing such great sales growth?

L. Nguyen: One of the game changers for us is how we systematically convert data into useful information. We call it our Business Intelligence and Business Analytics system, or BIBA for short. The world is awash in data and the challenge is to separate the wheat from the chaff so we can focus on the information that matters most. An ex-

ample of that is the tremendously powerful data we get from the single most important consumer 'touch-point' we have: our retailers. We wanted a system to capture large volumes of data to be sure the picture was accurate and not just anecdotal. But then we need to categorize and classify the data. From this data, we needed to identify the real performance drivers, and isolate those into a manageable number of key indices to focus on. Narrowing the focus of this particular example even further, we wanted to determine activation levels of new tickets, multiple \$5 games, and whether retailers were facing what we call the "ideal mix of games." Knowing this down to the retail level as soon as possible has really helped us make better decisions sooner.

This system allows us to identify retailers that weren't following the program so we could focus our energy there. Or we look for patterns. Like a game that is performing well in one district and not in another. We can quickly look to see if there are differences in activation levels or other factors to determine the cause and take action. Immediate action is the key. The information is of no use if we don't act on it quickly since instant tickets are essentially a fast moving consumer good. This also enables us to identify 'best practices' and replicate them, and also identify and correct weaknesses. None of this is anything that lotteries do not already do in some fashion. It's just that we are attempting to systematically inform the whole messy process with the most comprehensive data-base possible, eliminate the guesswork, and eliminate the business of extrapolating relatively small amounts of data into far-reaching conclusions. It is all a work in progress, but I can tell you the quality of the guidance turned out by our BIBA system has made a huge difference for us. We know that the decisions we make as to how, when, and where to allocate resources and guide our supply and distribution chain partners are based on solid, reliable intelligence.

Congratulations for achieving the highest level of Responsible Gaming in the United States with the Level Three Certification from the WLA (World Lottery Association). I find it interesting that in spite of your mandate to reduce administrative expenditures as a percentage of sales, and in spite of a crowded agenda, you invested in the process of qualifying for the WLA Level Three Responsible Gaming Certification. How rigorous a process was it, and what are the benefits to your stakeholders?

L. Nguyen: It's quite rigorous, very comprehensive. But it's not an investment that we've made recently. The Lottery Act (our guiding statutes) stresses the importance of integrity, security, honesty, and fairness. This is why it established a division of sworn peace officers right

here at the Lottery. Today, our security and law enforcement division is second to none in our industry. Responsible gaming is something that we have been investing in since our inception. In fact, we created the first problem gambling hotline in California. And we continue to make improvements. The WLA certification has ten pages of requirements. The business is scrutinized from every angle. It is not just about problem and under-age gambling prevention. It is also about transparency of your operation, communication to your players about the games, as well as the security and anti-fraud efforts you have in place. It took us awhile to put it together and to evaluate our business. It also encouraged us to launch initiatives and make improvements in the way we address all these different issues.

What caused you to decide to allocate the time, effort, and money to earn that WLA Certification?

L. Nguyen: Running a lottery requires balancing the needs of lots of different constituencies, some with conflicting interests. Common to all our constituents, though, is the need for us to preserve the integrity of the California Lottery. Nothing else is really so fundamental to the value of this brand as integrity, and nothing else is so fundamental to the value of the asset as the brand. We view the investment we made in responsible gaming as having the best ROI of anything we could possibly do. Without integrity we would not have a lottery. It was important for our management to be evaluated as to our performance in this regard, and it will also be a useful tool to have when discussing public policy considerations with policymakers. The California Lottery has put a lot of time, effort, and resources into responsible gaming over the years and I think the lottery and the staff deserve to be recognized for their efforts.

Do you see it as possible to have a nationalized approach to branding and advertising of one of the big multistate jackpot games? My thought being that of course not everything would be nationalized, but isn't there some small portion of it that could be coordinated on a national level?

L. Nguyen: I think it is possible for the various jurisdictions to find common ground. Even if we can't get complete census, I think that we can get the most out of any multi-state game advertising by coordinating a campaign. This is especially helpful to smaller states that don't have as many resources. Increasing sales in all states helps us by accelerating jackpot growth. If there were a way to make it happen, that would be a great thing for multi-state games. I would be in favor of getting a unified branding and advertising approach together. Regardless of the difficulty of getting 44 jurisdictions to agree, it's worth embarking on the effort to develop a nationalized approach,

even if it is for a relatively modest objective to start out with.

You are in the middle of your three-year plan. What is your action plan for the third and final year of the plan?

L. Nguyen: Year three is when we look seriously at changes to our jackpot games and increasing our web presence. We're doing the research now and planning on pulling the trigger on some of those changes in fiscal year 2013. The other area of focus in the third year will be internet. We are already ramping up, and expect to accelerate the process in the third year of the plan and have a really robust player loyalty program. I'm really excited about how well we are doing and all of the things we have planned. But I am most proud of how everyone in our organization rose to the challenge and continues to exceed expectations. ♦