



OKLAHOMA LOTTERY

Benefits Oklahoma Education[®]

PGRI Introduction: The Oklahoma Lottery was started in 2005. Having served in the Office of State Finance for 29 years, Rollo Redburn was among the first to be tapped for the start-up team. Having served as Director of Administration for the first seven years under Lottery Industry Lifetime Achievement award recipient, Jim Scroggins, Mr. Redburn was appointed to lead the OK Lottery in June of 2012.

Oklahoma is a very conservative state and has pursued a conservative approach to the lottery business. One of the constraints imposed on the Oklahoma Lottery is the requirement to allocate 35% of sales to net funds. Requirements like this do make it hard to continue to deliver the kind of value proposition to the consumer, at least in the form of prize-payouts, that drive sales. But that's just part of the job of the lottery director, to find ways to meet the expectations of a diverse set of stakeholders and public policy objectives.

Rollo Redburn Executive Director, Oklahoma Lottery Commission

Paul Jason, Public Gaming: *Cross-sell of Mega Millions and Powerball has had mixed results for the Oklahoma Lottery.*

Rollo Redburn: Like everyone, we assess the pros and cons of a proposal based on the needs of our own state, our markets, our lottery. We opposed the cross-sell that enabled all lotteries to sell both Powerball and Mega Millions, and we also opposed the increase in Powerball ticket price to \$2. Our analysis at the time told us that cross-sell was not going to be a plus for Oklahoma. Texas is adjacent to Oklahoma and sold Mega Millions but not Powerball. Now Texas and Oklahoma sell both games. Since Powerball was such a strong brand in Oklahoma, we determined that adding Mega Millions to our arsenal was not going to be a valued-added proposition. Mega Millions has sold well, but not well enough to make up for lost Powerball sales which is what we predicted.

The fact is that our Powerball sales started to flatten out before Cross-sell was implemented in 2010. Sales went down by almost 50% between FY2010 and FY2012, when they ended up just short of \$60 million. And even at the di-

minished sales level, Powerball is 35% of our total sales. So we do not want to see changes that negatively impact our best game. We can attribute part of the decline to the economy, higher gas prices, and other external factors. But the single biggest reason for us is the absence of higher jackpots. There's just no getting around the fact that higher jackpots drive sales. Those high jackpots are so vital not just for the performance of Powerball, but also because they have a powerful residual impact on the entire portfolio of games.

How about the price increase of Powerball?

R. Redburn: We supported a different approach that would have kept the price of the Powerball ticket at \$1. We felt that enhancing the matrix to create larger jackpots was a better way to produce the desired result of higher sales. Another factor we had to consider was the negative impact the change to \$2 would have on Power Play, which it did. In the end, the change to \$2 has helped sales, just not as much as was projected. Powerball FY12 sales ended up 7.3% over FY11. And I'm confident that as jackpots roll better, we will see Pow-

erball and Mega Millions sales increase at a faster rate.

You just started selling Mega Millions in 2010, and your sales are up to \$27 million in FY 2012.

R. Redburn: Yes, and now we have two established brands, two big jackpot games that are differentiated and give the consumer more choices. The additional super jackpot game gives the Lottery a broader portfolio of games and that is important because it gives us flexibility and marketing options. So even though we initially supported a different approach, we hope that this new product mix, a \$1 MegaMillions game and a \$2 PowerBall game, will put us in a better position in the future than we would have been if we kept everything the same as it's been our first 7 years in the state of Oklahoma.

The concern is that we are totally dependent upon high jackpots which may or may not roll. For instance, our Mega Millions sales increased by 30% in FY12. That's good, of course. But that increase is almost entirely attributable to the biggest jackpot in history. And game changes like what we have done over the last three years, with cross-sell and increasing the price of Powerball, introduce an element of risk and uncertainty. From a business point of view, downside risk should be complemented by a commensurate upside potential. I'm just pointing out that the potential has not been realized, we have not achieved the results that were projected, and we need to push for better performance from our multi-state super jackpot games.

The dependence on jackpots could become an even bigger problem if the jackpot threshold that gets the media attention keeps going up.

R. Redburn: It wasn't long ago that we were perplexed that the magic number to get players excited had risen to the unbelievably high number of \$100 million. Then it became \$150 million and now even that pales in comparison to recent jackpots. Where does it end? This poses a challenge that must be solved for the games to be sustainable.

Your website promotes your players clubs and mobile applications. How have these evolved and how do they contribute to sales?

R. Redburn: We are very focused on both of those initiatives and they are going very well. We offer lots of promotions to keep the players engaged. We have 48,000 Players Club members. The Mobile Club is separate and has climbed to more than 55,000 members in less than two years. Our mem-

bers sign up to receive e-mails and text messages which keep them posted on jackpots, new games, and special promotions, some of which are offered only to the Club members. We also use other social media like Twitter and Facebook to keep the players informed and engaged. By the way, a favorite promotion was delivering ice cream to the work site of the promotion winner on one of those 105 degree days we had this summer.

Is there a way to measure the impact that these initiatives have on sales?

R. Redburn: We can observe the impact that these initiatives have on consumer behavior. We can measure the number of members and there are different indices that measure levels of engagement. And our analysis of the data that shows increasing numbers of consumers registering in our Players Clubs and becoming Twitter followers and Facebook fans causes us to be quite confident that this positive consumer response does translate into increased sales. There is no doubt that the ROI on our investment in social media is very positive. And with our low prize-payouts, we need to use every available method to create value for our players, extend game play so that the consumer stays connected to us, and promote our brand and products. The results may not be directly measurable, but we know that the increased consumer engagement can translate into increased sales. Too, we should all realize by now that future success depends upon creating that consumer connection. Millions of people buy lottery products at retail stores. But that is an impersonal transaction. They're just buying our product like they buy any other consumer product and so it is becoming commoditized like any other consumer product. We need to build a relationship with those consumers, turn them into customers so that they think of lottery as something they affiliate with, have a genuinely positive feeling for, and not just think of lottery as a commodity. Social media is our bridge to a future that is based on the kind of interactive relationship that allows us to shape the relationship that consumers have with lottery.

Are you making progress on the National Game, or is it called Premium Game?

R. Redburn: I believe it is "Premium game", but I cover my bases by calling it the National Premium Game. And yes, I do think we are all optimistic about the possibilities for a new kind of multi-state game. In Oklahoma, we still need the games to have high enough margins that they do not impair our ability to pay back 35% to the state. That restriction applies to the revenue derived from

all the games we offer, including those where we do not decide the prize-payout structure.

What do you see as the most important consumer trend line in lottery, or gaming in general?

R. Redburn: The most important thing for lotteries is to evolve the games to stay interesting and fun for a new generation of players. And to make those games available on all the different channels including Internet, Mobile, self-serve kiosks, and whatever new media and POS come into popular usage. We can see some states moving forward with enabling legislation and we hope that will inspire others, like Oklahoma, to be comfortable that we too should expand in that direction. Land-based retail will be the sales driver for many years to come. But lotteries do need to evolve their relationship with the consumer to include digital and social media of all different kinds. Sustainability is a big theme now, and building the multi-channel approach to marketing and distribution is key to a sustainable lottery business. The evolution of lotteries will have to be tied to smart phones and tablet computers. It won't be for quite a few years, but eventually the majority of this business will be an electronic-only business.

Oklahoma has always had a very restrictive prize payout structure. States that have granted more flexibility to the lottery have experienced significant increases in sales and net funds. California is just the latest example. Is the Oklahoma legislature considering doing something similar, giving the Lottery more flexibility to increase prize payouts by focusing on net funds in toto as opposed to percentage of sales?

R. Redburn: Oklahoma is a very conservative state and the goal of increasing lottery sales and net funds is just not a high a priority for our legislature. The public policy agenda of our legislature appears to be that we meet the consumer demand for lottery products by making lottery products available. And the fact that net funds go to support Public education is appreciated by everyone. But it is simply not the public policy agenda of our legislature for us to drive sales. It's true that this is a conservative way to operate the lottery. But it is the approach that our legislature feels is best for the people of the state of Oklahoma. I, the Trustees of our governing board, and our complete staff all support removing the existing profit restriction so that we can provide more funding for Oklahoma education programs and we will continue to work on getting that law changed. I also firmly believe that the 65-68% of voters who

supported our two State Questions back in 2004 want more money to go to education and are supportive of this change. In the meantime, we will operate the best we can according to the law as written.

While I do respect the prerogative of the legislature to decide what is best for the people of Oklahoma, I am still curious about the underlying dynamics in a situation like this. Isn't there any political support for increasing revenues for Public Education (the beneficiary of OK Lottery funding) by giving the Lottery more latitude on how to run the business? Or, do the citizens, the voters of Oklahoma, really oppose the lottery and penalize a legislator who shows support for the lottery?

R. Redburn: It is likely a combination of factors. I would say that there are people in our state who do not believe a lottery is the best way for government to raise funds, regardless of who the beneficiary is. There are several other different reasons why someone might oppose a lottery. The bottom line, though, is that the views of everyone must be respected. And in a democratic system, political representation should reflect the will of the public. The legislature of the state of Oklahoma feels that they are representing the views of the citizens of Oklahoma and that view is that we should take a conservative approach towards the Lottery. My job is to implement the will of the legislature and the Lottery's Board of Trustees. Of course, I am honored to be the person selected to do that.

I know your next question will probably be about Tribal casino gaming, which is huge in Oklahoma. As in, Why the public policy ambivalence about lottery when there is so much casino gambling in Oklahoma? The answer is that the legislature looks at this as two separate issues. And that just because there is lots of casino gambling doesn't mean that we should therefore promote lottery play. Legislators may or may not support Tribal gaming, but Tribal gaming is an issue that is simply not on their radar and won't be for many years. Tribal gaming is in the half-way point of a 20-year compact. I'm not involved in any discussions about tribal gaming, but I would guess that nothing is going to change on the issue of Tribal gaming for at least ten years. There are more pressing issues for our legislature to address than something they can't influence for ten more years. By that time, I predict that the gaming industry in Oklahoma, mostly run by tribal governments who are a valued partner with the State, and games offered by the State Lottery, will be viewed in an entirely different light. I expect by that time the value of the

Lottery will have been recognized and we will have been allowed to maximize our contributions to education years earlier.

While our legislature as a whole does not support our wish to remove the 35% profit restriction, they appear to respect our ability to operate the lottery, seldom criticizing the Lottery and rarely questioning our actions and methods of operation. Yes, the requirement to turn over 35% of revenues to the state inhibits our ability to increase sales. But insofar as the results we produce are consistent with the will of the legislature, then this is just an example of democracy at work and I for one feel very good about our ability to impact that in the coming year or two.

Is there consideration to remove constraints on prize-payouts?

R. Redburn: The material constraint is on the percentage that the OK Lottery is required to turn over to the state in the form of net funds, or "profit". We are required to turn over 35% of sales. Of course, retailers need to be paid a commission and we have operating and marketing costs to absorb. When you add those costs to the 35% that goes to the state, that leaves around 53-55% for prize-payout. Louisiana is the only other state required to allocate this high a percentage to net funding. California used to have a similar requirement and it resulted in lower than average per capita sales. They modified that last year with the result that both sales and total net funding increased significantly. The top-performing lotteries all have much higher prize-payouts. But it is the 35% profit requirement that is the relevant constraint which makes it impossible for us to deliver more than a 53-55% prize-payout, and makes it impossible for us to increase our contribution to Oklahoma education programs.

I suppose there could be a variety of reasons for a constraint like that. But I will be so bold as to observe that some lawmakers seem to have a hard time grasping the concept that lowering the percentage of net profits does not result in lowering the amount of gross profits. In fact, the opposite is always the case. Net funding increases in every single case where the net profit requirement is modified. It is not an accident that the lottery with the lowest percentage of net profits (Massachusetts) actually delivers the highest per capita net funds to its beneficiary. Economics 101 teaches us about price elasticity and that consumer demand, and sales, increases as the value proposition increases.

R. Redburn: It is true that modifying the net profit percentage requirement would en-

able us to improve the prize-payout percentage. And the evidence is in that the consumer perceives the increased prize-payout as a better value proposition and that results in an increase in sales. And that even though the percentage of sales that goes to net funding decreases, the increase in sales more than offsets that and results in an increase in total funding. What isn't true, though, is that our legislators don't understand that. They do understand that concept, and I think they are acting in what they feel is the best interests of their constituents. I have worked with the legislature for 36 years so I have come to appreciate that and the role they perform. However, my appreciation for the pressures they have to face won't slow us in our efforts to get the law changed.

I still don't understand the purpose of a net profit requirement. The objective of commercial businesses is to maximize profits, and they're happy with 6% net or even less. I do realize that lotteries do not aspire to operate like commercial businesses in that respect. But when the net margins are too high, and the resulting prize-payouts too low, the consumer is discouraged from playing. Decreasing the net requirement to 25%, or removing it altogether, would just be a much better business strategy and result in more funding for Public Education. Of course, the Lottery would still comply with the highest standards of operation and responsible gaming. It's just that you would have a product that would appeal more to the consumer. California is the latest example for how that whole dynamic works in the real world.

You're preaching to the choir. I can't speak to all the reasons behind legislative decisions. I can tell you that legislators, and all of our stakeholders, are very smart people and do understand everything you are saying. The fact remains, though, that there is a contingent of voters in Oklahoma who do not support any kind of games of chance including lottery. Our lawmakers are responsive to those sentiments and so do not come down in favor of initiatives that would help us to increase sales of lottery products, even though that would result in an increase in funding to Public Education. The choice could be between having \$65 million in net with a 35% margin, or \$72 million net with a 25% margin. And they are choosing the lower profit figure. But it is up to the legislature to decide the importance of funding to Public Education relative to other considerations and needs for funding.

I thought the ad in which you talked about the beneficiary, public education, and the importance of funding for school children, was really excellent. But you were told to discontinue that campaign, weren't you?

Thank you. We received more positive feedback from that ad campaign than any other. For that campaign, we used school children in our beneficiary ad's in which we were telling the public that net funds from the lottery goes to support Public Education and why that is important. The ad' talked about all the things that funding from the lottery could allow the Public Education system to buy. Some people objected to the inclusion of children in our advertising, even though the point of the campaign was not to use underage children to sell lottery products, but to promote the public service role that lottery funding supports. Others objected because there was disagreement over exactly how net funds were being disbursed. So a law was passed that prohibits the use of people under eighteen years old in any of our advertising.

There was disagreement over who was receiving the funds?

R. Redburn: Like most lotteries, we do not actually execute the disbursement of net funds. In our case, Lottery raises the money, but then turns it all over to the state for disbursement according to legislative direction, or appropriation. Technically, under our constitutional provision and under the state laws that enabled the state to implement a state lottery in the first place, the net funds can go to a variety of different causes, all of which relate to Public Education. Some of the funds might go to things like vocational tech education or higher education. The ad' talked about some of the recipients but not all of them which caused some people to think that if we are going to talk about the beneficiaries of lottery funding, we need to be more precise about where the funding goes. Too, technically, Lottery net funds that are appropriated to Common Education go into a more general Public Education fund that is allocated to the individual schools to actually purchase

the goods and services. So some people objected that we should not claim that lottery funds actually purchased specific things, like school buses, books, desks and computers , since there is no mechanism that ties a specific disbursement of general funds to a specific source of funds. Frankly, we did not even say that Lottery funds purchased those specific things, only that those are the kinds of things that Lottery funds could help to buy.

For our part, we understood the concerns of those who want more clarity. While we don't agree with the prohibition on using children in such beneficiary ads, we are sensitive about the appearance of children in lottery advertising and we will follow our laws. Overall, another good learning experience! ♦