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PGRI Introduction: The theme of our next event is “Globalization of Best Practices”. So, it is very exciting when one of our own gets to participate in a quest to strengthen relations and to learn from a visit to the biggest economic story of the last two decades: China. My discussion with Mr. Rich ended up touching on two other pressing issues as well: Political action to defend states’ rights interests and leveraging the success of multi-state jackpot games.



ON GLOBALIZING OUR PERSPECTIVE OF THE INDUSTRY

Paul Jason, Public Gaming: *The theme of our next conference is the “Globalization of Best Practices”. So your trip to China really caught my attention. What was the specific purpose of that trip?*

Terry Rich: My trip to China was part of an ongoing effort to foster more interaction and shared learning experiences, and also to develop mutually beneficial business relations between the state of Iowa and China. The Iowa/Greater Des Moines Partnership has built a great relationship with China over the years. The new Vice President of China has had a close relationship with the state of Iowa, visiting Iowa many times. Xi Jinping was the guest of honor at a state dinner event in Iowa last year.

One objective of my trip was simply to

learn about another business culture and hopefully acquire a more global perspective that can be applied to the way we think and operate as government leaders. As CEO of the Iowa Lottery, I try to bring in ideas and best practices from outside of our state experience. Another objective was to see how the products and business strategies of our primary vendor, Scientific Games, are being applied in a completely different market and gaming culture in China. I visited their group in China and learned more about how the business operates in China.

How does consumer behavior or buying motives differ from those of the United States?

T. Rich: I can’t presume to be an expert on that. But I would observe that the Chinese are fascinated with numbers. Numbers

and symbols have meaning beyond what they do in the West - almost a mystical or spiritual power. Then, combine that with the Chinese sense that everything happens for a reason. Winning the lottery is not just a result of happenstance or luck. For instance, we had a casual lunch with some small business merchants and they had charts up on the wall to keep track of the numbers, hoping that they could see patterns that might yield some predictive value. I don't think they think of it as a scientific method approach that Westerners might attempt - more a matter of discerning the underlying meaning behind symbols and numbers combined with the conviction that everything has a reason and higher purpose, even the possibility of winning the lottery.

What are some other impressions of China, not just as they relate to lottery?

T. Rich: In many ways, China is not so different from America, though our tour may have been arranged to create that effect. We toured the local produce markets, the agriculture communities, the major political center of Beijing, and the commercial hub of Shanghai. Shanghai is beautiful and modern. Beijing is 2,000 years old. But wherever you go, construction is going at breakneck pace, with hundreds of cranes visible in every direction.

One difference that I found to be curious is the Chinese people seem to have more trust and confidence in their government than we do. They love their country. They respect their government and believe that what the government tells them is true. It is part of the U.S. culture to be suspicious of authority in general and that colors our attitude towards government. It's not that way in China.

China's middle class is growing but is still much smaller than the lower class. Everyone I met feels strongly that their social welfare system, and their system for feeding people, is the best in the world. The population in China is over 1.3 billion, like four times that of the U.S. And yet they say they have no starvation. For instance, the government basically designates locations for each citizen to live and in turn cares for the people who comply with that system. There is an explicit policy to limit family size to one child, so it is very expensive for a couple

to have more than one child. The Internet is controlled, censored. I noticed Facebook was actually blocked when we were there. These are some freedoms that they give up in return for a social welfare system that would appear to have some progressive attributes. Trying to eliminate starvation in the most populous country in the world is quite an admirable goal. Now China is moving towards the creation of a robust middle class and more potential for individuals to advance and change their personal social and economic status. They encourage entrepreneurial talent from within their ranks, and they welcome technology and management skills from all over the world. Already, production that requires lower-skilled labor is being outsourced to Taiwan and other countries where labor is cheaper. The people I met in China are convinced that the trade-offs are for the best, and a necessary component to their rapid modernization. After all, in many ways, the Chinese rocketed into a first-tier economic power in less than 20 years. It is an astonishing feat.

It would appear that the Chinese are fully embracing the culture of capitalism.

T. Rich: Certainly in many ways. But the markets have fewer competitors and so are likely to be less efficient than in the U.S. The entire system of accountability of public officials is totally different than in the U.S. Individuals vote to elect their local representatives who function like aldermen. Those representatives then vote to elect mayors, the mayors vote to elect regional senators, the senators vote to elect governors, and governors vote to elect the president and national officers. My terminology isn't precise, but the idea is that government is not accountable directly to the people but to itself. The positive aspect of this is that it can act more quickly and tackle the ambitious task of modernizing this country in a dramatically compressed timeline. And the different levels of government do impose a system of checks and balances. But when the prime minister gives a green light, it's full-steam ahead.

Business is much more open and freer than I anticipated. Perhaps ironically, they have more flexibility to assess the value of a commercial relationship than

we do in the U.S. In the U.S., it seems that every aspect of a vendor relationship must be quantified mostly by price. There are good reasons for that, but it does impinge on the ability of all of us to innovate, to try new things and take calculated risks that have uncertain outcomes. I do not presume to have the solution to that. And I am certainly not saying that I would trade our system for theirs; just that observation and understanding of how other systems operate might stimulate insight into our own situation.

How does the Chinese market and the regulatory system work?

T. Rich: The Chinese government does all of the online or terminal lotto business. It's my understanding that lotto outsells scratch-offs by a 3 to 1 margin. Lotto has existed in different forms for centuries. Scratch-offs are a newer game for the Chinese but are rapidly gaining in popularity and is the faster growing category.

What does the retail network look like?

T. Rich: The lottery has many "exclusive" stores where they sell only lottery products. The dominance of lotto-style games over a robust instant-scratch business creates an opportunity on which the U.S. lotteries have capitalized. Interestingly, high-frequency games (10-min. keno), sports betting and VLT's are all rapidly growing games in China and have put some pressure on the instant games as the newest games in the market.

There are distributors who manage a vast network of small retailers in the markets that are mostly opened up in the morning and shut down at night. In fact, many are called "wet markets" because they vend everything including food so the tables are all cleared off and hosed down at the end of the day. They do not seem to have big chain stores that sell lottery products.

It sounds like there is a huge potential to increase sales just by improving distribution. What about Internet and Mobile?

T. Rich: The penetration of mobile is very high and continues to grow rapidly. But I can't say that I saw any evidence of lottery products being bought over digital media.

ON POLITICAL ACTION TO DEFEND THE INTERESTS OF STATES' RIGHTS ON GAMING MATTERS

PGRI Introduction: There are many obstacles that prevent political action by lotteries and their directors. However, the biggest stakeholder of the lottery is the state that owns it and somebody needs to defend its interests. Lotteries do not have budgets for lobbying legislators. And yet, lottery directors are charged with the task of operating the lottery, and most directors feel that would include defending the interests of lottery stakeholders. And that would include ensuring that legislators at both the state and federal levels are making informed decisions when it comes to laws pertaining to gaming. Thankfully, a high-level delegation of lottery directors stepped up, travelling to the nation's capital and meeting with lawmakers who are charged with the task of shaping public policy. The mission was, and continues to be, to make sure that the shapers of public policy have all the facts and a clear understanding of the impact of laws affecting the regulation of gambling. On the front burner right now is to prevent the usurpation of the authority of the state to regulate and tax the gambling industry. The regulation and taxation of gambling has always been under state authority and control. The only federal law essentially states that all forms of gambling are illegal until and unless a state government chooses to regulate and tax it. Commercial gambling interests are now attempting to change that law such that the federal government would regulate internet gambling. We want to thank and commend Directors Arch Gleason, Charlie McIntyre, Debbie Alford, Jeff Anderson, May S. Reardon and Bill Hanson; David Gale and the staff at NASPL; the lottery Vendor community; and other lottery management staff for their efforts to speak up in defense of states' rights and the rights of all lottery stakeholders.

What was accomplished by your trip to Washington, D.C., last month?

T. Rich: We met with lawmakers and representatives from around 100 Congressional offices to discuss the issues, explain some of the implications and impacts of legislation being proposed, and express our concerns. Our goal was to deliver a clear and consistent message: All forms of gambling have always been regulated and taxed by the states and that should not be changed. Legislation has been proposed that would federalize Internet gambling or Internet poker and that legislation should be vigorously opposed. This is not just about the rights or concerns of lotteries. It is all about the rights of states. We pointed out that, as lottery directors, we are just like the legislators we met with in the sense that we are all public servants with no financial interest or angle other than to serve our state. We just want to do what's right for our communities and the worthy causes that depend on the funding from lotteries. Unlike the advocates for federalizing the regulation of i-gaming, we don't have a war-chest of millions to mount a big lobbying campaign. In fact we have no budget at all for educating leaders about our story. What we do have is a message that should compel legislators to consider the impact of changes to a regulatory framework that has governed the gaming sector well for decades. We were extremely pleased and impressed by the attention we were accorded and are confident that our message is being carefully considered.

I was even somewhat surprised by the reception we received, the openness of all of the states to hear the story. Even though Utah does not even have a lottery, Senator Orrin Hatch's top staffer met with us, listened to our story and shared his views. All the legislative offices expressed a genuine desire to get both sides of the story, to hear and understand everything. I can't say they were all committal, but they were all sympathetic to the concept of preserving states' rights. And they were very sensitive to the fact that state governors and legislators are almost unanimous in their opposition to the Reid/Kyl bill.

Were you joined by representatives from vendors to the lottery industry?

T. Rich: Yes, and they should be given credit for smoothing the way for us to get our message heard. The organization and professionalism of our vendor community and their government relations teams was astounding. They know what they're doing, they know how to get the messaging into the hands of the right people. And they are working hard to defend the interests of lotteries, our stakeholders, and the states. So it was a pleasure and an eye-opener to get the opportunity to work with them on this project.

What was the essential message?

T. Rich: The basic message is that regulation and taxation of gambling of all varieties, whether it is casinos, internet, mobile, i-poker or slots or whatever – all of this should be under the authority of the states. There is no

need for the federal government to intervene. And federal intervention would serve no purpose other than to destabilize a system that works perfectly fine as it is. The only ones that benefit by such intervention would be private commercial gambling interests and that would come at severe cost to the states. Any and all public policy debate needs to be held at the state level. That system has always worked well and there is no reason to change it. Nevada may choose to regulate and tax gambling differently than its neighboring state of Utah. Illinois may choose to sell lottery tickets over the internet, but that is only to Illinois residents. Other states may choose to prohibit internet distribution of lottery tickets. Delaware and others may choose to implement i-poker while others choose to prohibit it. States can choose to pool their markets together if it serves their interests to do so. They already do that for lottery games and could do it for i-poker as well. The government of each state is in the best position to decide what is the best public policy for the citizens of that state. Just as it would be wrong to insist on federalizing the regulation of bricks-and-mortar casino gambling, it would be wrong to federalize the regulation of internet gambling or i-poker. It's a simple, clear, straightforward message.

Did you refer to the specific implications of the Reid/Kyl bill?

T. Rich: We absolutely added our voices to those of governors and legislators who

already had expressed that the proposed legislation from Senators Reid and Kyl would be a departure from all precedent, why it is unnecessary, and why states are best suited to continue to regulate and tax internet gambling just like they are best suited to regulate and tax all the other forms of gambling. There is really nothing about internet gambling that should cause it to be treated any differently from all other forms of gambling. Age and location identification technologies have been operational for many years and proven to be effective. So i-gaming can and should be regulated on a state-by-state basis just like all other forms of gambling.

Gambling is a unique industry. Public policy needs to be sensitive to the needs of the people, and those needs vary from state to state. States need to have the authority to decide what is best for their citizens, and to protect the interests of their citizens from over-reaching casino gambling interests. And that is why it would be very misguided to impose a federal framework that would over-ride the concerns of individual states.

What is the likelihood that bills on the federal level can be introduced again and again until something onerous eventually passes?

T. Rich: We can certainly expect that there

are people who will keep trying to pass legislation that will attempt to give the casino gambling industry an advantage by abrogating state authority to regulate the industry. I would like to think that understanding of the issues is the best defense against that happening, that our legislators are more informed now than ever before, and that awareness of these issues is increasing with every passing week.

It sounds like your approach to these meetings and to this whole issue is one of measured desire to have an open dialog as opposed to my high-pitched self-righteousness. Your toned down professional approach must be better at creating thoughtful and open-minded dialog.

T. Rich: I can get somewhat animated about the issues too. But we do need to be clear on the mission. Different states have different public policy agendas relating to gaming. We need to respect that fact and focus our message on the specific issue of preserving the rights of states to determine regulatory and taxation policy for all forms of gambling. We also need to respect the fact that lawmakers need to consider a wide variety of factors and we are not the experts on all of those factors. Hopefully, that measured approach will bring about the best reception

for the core message of protecting states' rights to control gaming.

Can we be hopeful that NASPL can start assuming a more politically active role?

T. Rich: As you know, there are limitations to what NASPL can do. It is partly related to funding. But this will probably go down as one of the best-led initiatives that NASPL-member lotteries have conducted. David Gale, his staff and the NASPL Government Relations committee should be commended for the effort. As regards to future efforts, NASPL also needs to represent the interests of all of its members and basically constrain its messaging to that which is supported by all of its members.

ON INNOVATING THE MULTI- STATE GAMES

First, congrats for your continued success. Iowa Lottery sales are up by like 30% over the last two years. Isn't there a limit to how long you can maintain a double-digit growth rate? I'd think you'd run out of runway at some. ♦