



## Jodie Winnett

Acting Superintendant  
of the Illinois Lottery

The Illinois Lottery generates over \$650 million a year in net funds for education and has recently announced that Oliver Wyman has been retained to help build a private management contract, effectively outsourcing large portions of the management of the state lottery. Following is a discussion about the purpose of this Illinois initiative, and addresses the differences between “privatization” and other forms of ownership/management structures.

**Public Gaming:** *Could you explain what is it that you, the state of Illinois, and the IL General Assembly hope to accomplish with the outsourcing of the management of the state lottery.*

**Jodie Winnett:** Our Illinois State Senate President John Cullerton has been actively studying the lottery for a number of years. He and his colleagues in the Illinois state legislature have been exploring the pros and cons of the many different ownership and management structures. This kind of initiative is driven by our state legislature, not the Illinois Lottery.

They started with the basic challenge of how to fund the huge investment required to rebuild our public infrastructure and create jobs. The capital plan is in place to accomplish these pressing objectives but the funding is not. Everyone agrees that the Illinois Lottery has the capacity to deliver more funding. The question is how to best achieve

that. The senate president communicated these thoughts to us some months ago, helping us to understand their fiscal objectives, the capital plan that would guide strategies to achieve those goals, and the funding mechanisms that would support the capital plan. We worked with his staff on some clarifying language in the bill. The governor very much signed on to the capital plan and all the proposed funding mechanisms. There were several, and this is one.

And that’s what we’re pursuing. We hired Oliver Wyman to help us analyze the options and clarify the contours of our plan to. For instance, I said that there is agreement that there is more potential in the Illinois Lottery. The first order of business is to analyze the business, assess and evaluate where that value is likely to come from. We need to get more specific on what the upside potential is. What are the mechanisms that are going to get us

there, and are the policymakers comfortable with those directions. For instance, Illinois is not a state that offers Keno. But clearly there would be revenue potential in offering that game style. Is that what the policy makers want to do?

There are going to be many complexities that need to be figured out. Framing the questions that will enable us to clarify the objectives will be the first task.

*You mentioned the possibility of Keno, and there is the possibility that internet gaming could have an even bigger impact on the income generating capacity of the lottery. How can you project future profitability without knowing which games the lottery will be authorized operate? How do future earnings get factored into present value when nobody can predict what the earning potential will be? And so how can the asset be accurately valued?*

**J. Winnett:** First of all, Paul, there’s nothing being sold here. This is a vendor agreement. We are hiring a manager for a fee. I think that’s been one of the big misconceptions out there. This is not a privatization. It is a form of outsourcing. Lotteries already outsource many different aspects of their operation. This should more accurately be considered a new twist on an old theme. We’ll be outsourcing some functions that others are not presently outsourcing. But like all lotteries in the U.S., the state of Illinois is very much keeping control and ownership of the State Lottery.

We are seeking to hire a private manager to oversee various aspects of our operation. They will be paid a fee, and there will be performance incentives built into the contract. There may be different tiers to the fee structure. These fees will probably take the form of percentage of proceeds. Addressing your question, we will dial into the contract the flex-

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ibility to base the fees on the degree of value added activity that a particular initiative or part of the business requires. For instance, if Internet gaming were to come to fruition, it will likely entail lower costs than the maintenance of the land-based retail network and so might command a lower percentage as a fee. The main idea, though, is that the state retains ownership and control over the lottery. If enabling legislation creates new sources of income, that does not become a windfall for the manager any more than it does for an executive in a corporation. We negotiate a fee that incentivizes the manager to optimize performance and the state of Illinois continues to enjoy the benefit of the profits that rightly belongs to the owner of the capital asset. So thank you for allowing me to clarify that this is not a privatization. The U.S. Department of Justice has made clear that states cannot privatize their lotteries, and we're not seeking to do that at all.

*It's a management contract that gives both parties, you and the manager, the ability to evolve the terms of the contract in a way that incentivizes the manager to increase profits and rewards the manager for good performance, but the state retains ownership and control over the lottery.*

**J. Winnett:** Right. We'll be looking for a management team, most likely a management consortium, to bring forward a business plan. We'll ask them to evaluate our position in the marketplace, assess strengths and weaknesses, identify opportunities to increase revenues and profits, propose the strategies to optimize the potential, and how corporate social responsibility and responsible gaming in particular will be integrated into their business plans. It is really not so much different from an RFP for an online vendor. Obviously it is more comprehensive than that, but it really is a matter of degree, not of kind.

*So the first step is for Oliver Wyman to give you an overview of different ways to go about structuring an RFP and RFQ. The next stage will likely be more of an open-ended type RFP where you're going to look at a wide variety of proposals as opposed to a more tightly drawn RFQ that would stipulate terms, conditions, and expectations.*

**J. Winnett:** We are evaluating that question right now. How much specificity should be written into the RFP versus freedom and flexibility to propose creative solutions. We will be directing the private manager to get creative and figure out exciting new ways to increase sales and profits. But we are also

imposing caveats and requirements that are probably more exacting than most corporations are used to. They'll be required to comply with the highest levels of social responsibility. Transparency in all aspects of management and operations and various fiduciary responsibilities will be stipulated in the contract. Oliver Wyman will help us to clarify that balance between the freedom of the manager to pursue better results and the need for the state to retain control.

*Will you expect a large upfront payment or will compensation be mostly in the form of fees on operating income and other ongoing performance indices?*

**J. Winnett:** Not determined yet. But a large upfront payment is not likely.

*If there's not a large upfront payment providing an infusion of cash into the state coffers, then the concept would seem to be that a private manager can improve performance and profitability over the way the lottery is being operated now?*

**J. Winnett:** Right, exactly. The Illinois Lottery operates as a division of a state agency in a very large government. As a profit generating business, it functions quite unlike anything else in state government. In some ways, it is required to conform to ways of thinking and operating that are not always conducive to peak performance in a business sense. A private manager will be expected to inject some private sector entrepreneurialism. Combining the public service focus of state government with the energy and entrepreneurialism of private industry is our strategy and will, we hope, deliver the best of both worlds.

*I think the record clearly shows that the performance of the Illinois lottery while under your direction as been excellent. What do you think a management group will bring to bear that the lottery as it is operated now hasn't shown itself perfectly capable of accomplishing?*

**J. Winnett:** Thank you for that. Yes, we have had a great few years amidst some very rough times here in Illinois. We are pleased with our performance. We are not in a position to introduce dramatically new games or play styles. So we focus on the fundamentals, on execution in every detail of the business. Our team has done extremely well. We've got a great team that has been really pulling together. They're professionals who know this business from years of experience and we are very proud of their accomplishments.

But the answer is that a private manager has

more flexibility than a state agency to manage a business for peak performance. And while I am proud of our accomplishments over the past few years, I would also like to think that a private manager will bring to the table some skill sets and competencies that are at least different from what you typically find in a state agency. Again, I am proud of the accomplishments of the entire Illinois Lottery team. It's not about someone or some management team being better or worse. It is about integrating the very best of all the resources we can to truly optimize the performance of the lottery. And creating an ownership and management structure that is most supportive of producing the best results.

*The U.S. Department of justice issued a statement some 18 months ago indicating that it is their opinion that federal law prohibits the sale or privatization of a state lottery. They did not make clear what exactly is meant by "Privatization." Presumably, a long-term lease with a large upfront payment would be considered a "privatization." And that's not what you are doing with this private management contract. But U.S. DOJ did not specifically spell out the terms and conditions that constitute "privatization." Did the Illinois General Assembly give much consideration to that when writing the legislation for this private management contract?*

**J. Winnett:** Yes. The DOJ did issue a statement expressing that opinion. We need to respect that. Our legislation was written in a way that is compliant with the directives of the DOJ.

*Many people think that the DOJ over-reached and would not likely take action to interfere with a state's right to manage its assets in whatever way it chooses, so long as the lottery operated within the borders of the state.*

**J. Winnett:** That may or may not be the case. It has become somewhat of a moot point now that the capital markets are much leaner than they were 18 months ago. At this point, I don't think there is a queue of bidders prepared to put up hundreds of millions of dollars for that kind of transaction anyway. But the fact is that we are very respectful and mindful of what the DOJ said. This management contract is constructed so that we do not turn over control of the lottery. The state of Illinois retains control and is outsourcing strictly some management functions. We are confident that this approach is in full accordance with the opinions and guidance of the DOJ.

*Is the contract with Oliver Wyman with the Lottery or with the Department of Revenue?*

**J. Winnett:** They're dealing with both of us, really. The contract has not actually been executed yet. We're in the process.

*But part of the answer is that the Lottery is integrally involved in this whole process, it's not something that's been taken over completely by the Department of Revenue and the IL state legislature.*

**J. Winnett:** The lottery is not only very involved; I would say we are the lead in the implementation of this private management contract.

*Excellent. It will serve the stakeholders well to have the process executed by the people who understand the business. How would you describe the difference between what you're doing and the 10 year lease of the UK National Lottery to the Camelot Group?*

**J. Winnett:** It will definitely be different but we can't say exactly how it will be at this point. I will say, though, that I do not think this is nearly the dramatic change that you may be thinking it is. Look at how the Texas Lottery outsources huge sections of its business, or how most of the modern lotteries are being set up as public corporations. And these public corporations tend to be the top performing lotteries. We think we are just doing a variation on the things that are being done very successfully already. We feel that engaging a private manager will introduce many positive changes to our operation. With the lottery still being owned by the state of Illinois, the stakeholders get the benefit of new and hopefully innovative operating perspectives from private management. And at the end of the contract term, the state gets back a healthy and valuable asset and can decide to move in a different direction if they choose.

*It occurs to me that the next few years will likely see some major changes in the gaming industry. Changes in technology, distribution channels, demography and player preferences, enabling legislation...all these changes pose some element of risk when it comes to strategically managing capital investment in technology and the business in general. To some extent, you are outsourcing that risk, or at least enlisting a fully vested partner to help you make the right capital investment decisions.*

**J. Winnett:** Exactly. Positioning ourselves to meet the challenge of a changing mar-

ketplace and the need to make continuous investment to keep up with those changes is very much a part of this agenda and why we are proceeding the way we are. I can't say we are outsourcing the risk, but our plan is to share that risk with a management partner who is just as focused as we are on making the right investment decisions.

We should also point out another element of risk. There is also the risk of not taking full advantage of the tremendous opportunities that lie ahead. One of the drivers is to position us to pursue those opportunities with as much vigor, creative energy and focus as possible, and that is where we expect the private manager to contribute. State government is more risk averse, which is not a bad thing as long as you clearly recognize and value the risk of missed opportunity as well as the risk of making a mistake. A private manager will be expected to bring something to the table in this area of prudent and shrewd risk assessment. A private manager will be expected to operate a more nimble organization that can bring on partners, perhaps bring on project-focused staff which is disbanded upon completion, and move in different directions as the business and markets require.

*It seems like the incentive to innovate can be different in the private sector than in state government. In the private sector, it is understood that if you create something really great that produces great results, the return for that isn't just great; it can often be fabulously great. Outsized results yield outsized bonuses. State government doesn't always operate that way, does it?*

**J. Winnett:** That is definitely a part of the purpose of the private management contract. We want to create the structure that supports that private sector approach to innovation and the cultural attitude that is comfortable with higher pay for producing really great results. A private manager should have the flexibility to invest more in R & D and enjoy a return on that investment that is not based on costs but based on the results. The reward needs to be results driven. If the manager is smart and efficient and succeeds at producing great results at a low cost, then they will make a big profit. Of course, the state of Illinois will appreciate it because they will also make more money. But nobody will object to the idea that a big profit went to the private manager. That's capitalism. That is a critical component to the drive to innovate and that is something that a private management contract enables. A state government agency is

just not set up to operate that way. Designing the contract and incentives to accomplish all of our objectives, which include operating in ways that state policymakers are comfortable with as well as exceeding financial targets and fulfilling all corporate social responsibility expectations, is a complex task. This is the main reason we have enlisted Oliver Wyman to help us. The business of assessing the business and projecting all the ROI's and designing an incentive contract based on those analyses involves heavy-duty analytics. Too, we are all very interested to see what this kind of highly sophisticated analysis will yield in terms of understanding this business. One of our objectives is simply to set in motion the mechanisms that will cause us to get a deeper insight into this business that produces hundreds of millions of dollars a year in net profit.

I think about my own reaction when reading about the private manager initiative and wonder how you feel about the reaction of the media in general. All of us need to have a more enlightened and open-minded perspective on the various ways that a state might explore its options. Different states will have different fiscal objectives and legislators should make it their business to analyze the various ownership/management structures and how to optimize the tremendous asset that is their state lottery.

*There was a reference in one of the news items about how this private management contract is expected to return a billion dollars over ten years. That does not seem like very much, considering the lottery produced \$650 million in just last year alone.*

**J. Winnett:** That's a mis-quote. What the \$ billion refers to is the goods and services the lottery currently pays for what would be perhaps under the purview of this private manager. So this private manager would be in a position to allocate about \$100 million in goods and services. That is approximately the amount we pay for our central gaming vendor, our advertising spend, promotions, instant tickets, and other operating expenses. In other words, it costs about \$100 million a year to run the lottery and that could possibly approximate what the private manager would be paid to cover all those operating costs. Over ten years, that's \$1 billion.

Facts can easily get mis-stated, especially as the story gets picked up by one and then another reporter. So hopefully we have set at least part of the record straight! ♦