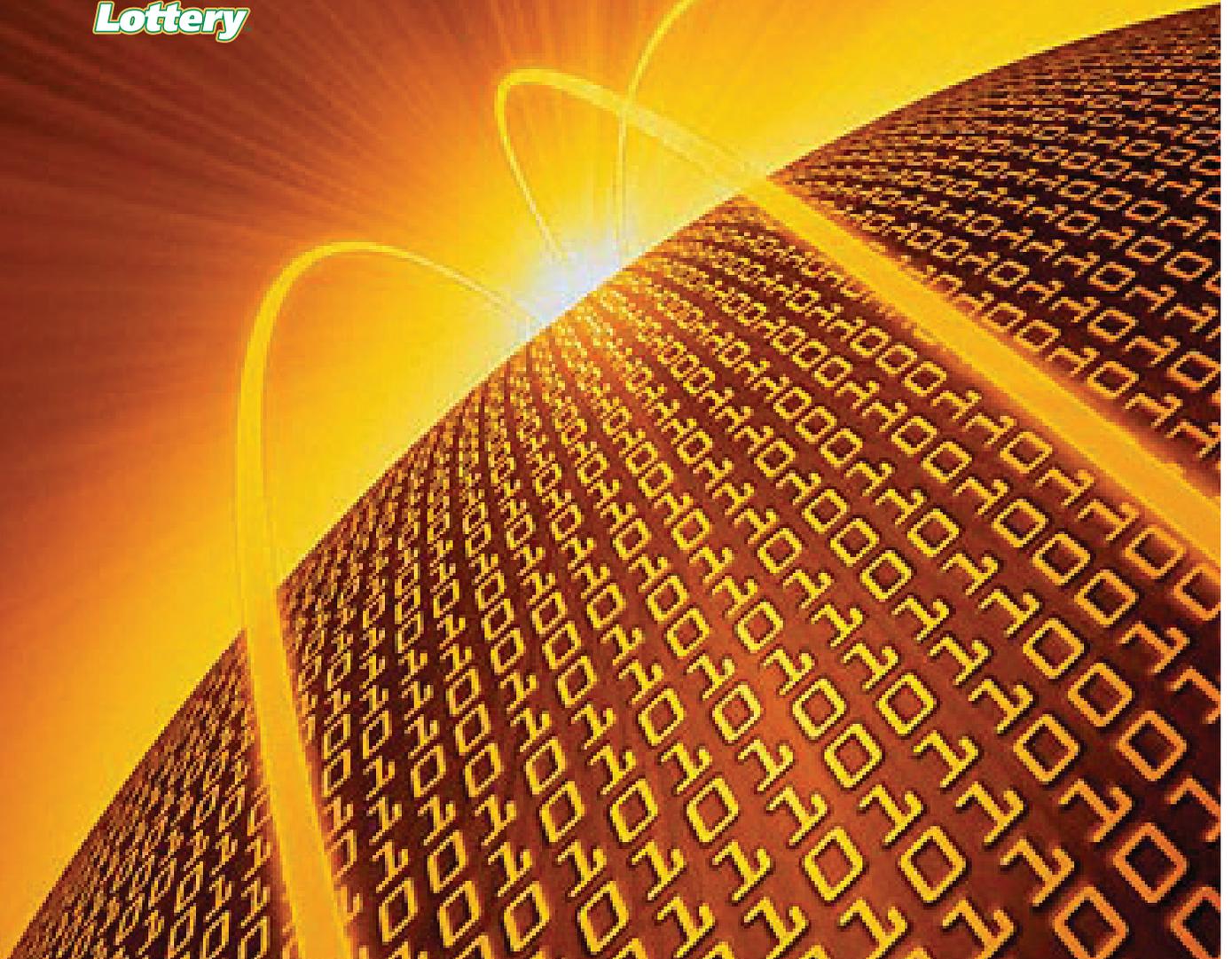




Washington
Lottery
2005-2007
Business Plan



Washington Lottery Business Plan

2005-07 Biennium

(Fiscal Years 2006 and 2007)

◇ **Mission Statement**

Provide funding for education and for community endeavors by maximizing profits from the sale of creative and entertaining lottery products.

◇ **Statutory Authority**

Created in 1982, Washington Lottery's enabling legislation is contained in Chapter 67.70 of the Revised Code of Washington.



Washington Lottery Business Plan 2005-07 Biennium

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Washington Lottery Business Plan

2005-07 Biennium

Business Description

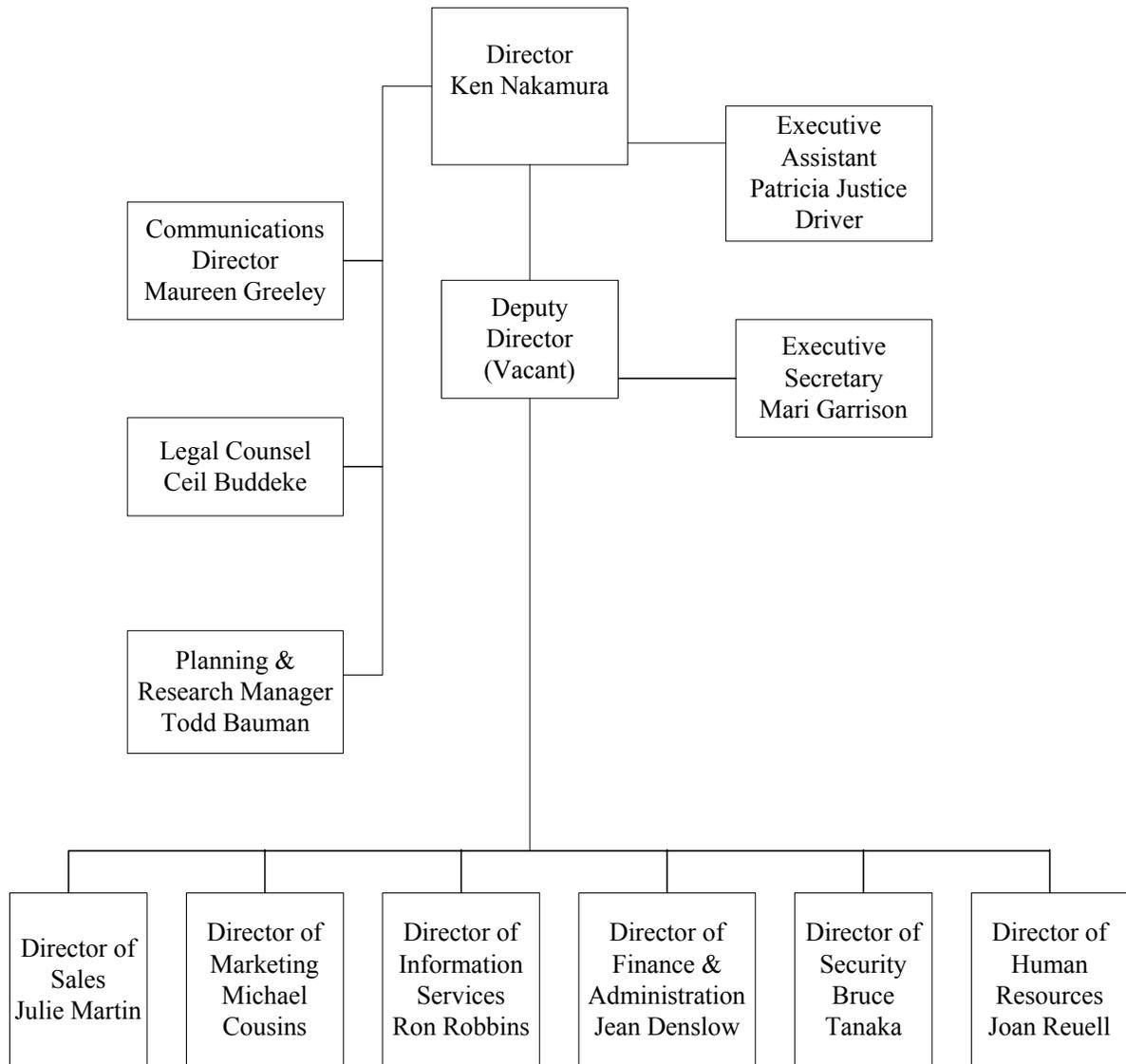
The Washington Lottery provides funding for education and for community endeavors by maximizing profits from the sale of creative and entertaining Lottery products. The Lottery's two current product lines include *Scratch* and number drawing ("On-line") games. When playing *Scratch* tickets, players scratch or rub off latex from a paper ticket to reveal whether or not they win. *Scratch* tickets range in price from \$1 to \$20. Current on-line games include *Lotto*, *Mega Millions*, *Quinto*, *Lucky for Life*, *Daily Keno* and *The Daily Game*. On-line games are drawn either daily or twice per week. Players win prizes by matching the selected numbers on a game ticket to numbers drawn by the Lottery. On-line tickets range in price from \$1 to \$2.

A small staff of only 152 full- and part-time employees operates the Lottery. (See high-level organization chart, next page.) Private contractors provide lottery tickets and the support systems to facilitate their sale at retail locations. The Lottery recruits and licenses retail business partners to distribute Lottery products. Currently over 3,500 retailers sell at least one of the two product lines.

The Lottery currently accounts for approximately 12% of the gaming market share in the State of Washington. The Lottery's sole competitive advantage is rooted in its legislated quasi-monopoly on the sale of gaming products at retail locations such as convenience stores and supermarkets. In addition, the Lottery is, for now, the only gaming choice in Washington that offers top prizes of millions of dollars for a wager as small as one dollar.

Competition for market share consists of tribal casino offerings of table games of chance (e.g., craps, roulette), house-banked card games (e.g., blackjack, poker), multi-draw keno, and VLTs (video lottery terminals). Private casinos and card rooms offer traditional poker in addition to house-banked card games. Unlike its competitors, the Washington Lottery is totally accountable to the public, and is also dependent on state government decision makers to authorize many changes necessary to meet customer demands.

WASHINGTON LOTTERY



Management Team and Executive Support, April 2004

Major Partners

- ❖ **Retailers:** The approximately 3,500 retailers selling Lottery tickets at their locations are the Lottery's single most important business partners. They represent not only the distribution network for Lottery products, but they are also the main point of contact with the players who participate in our games. The Lottery works with retailers not only to encourage the promotion and sale of Lottery products at retail, but also to ensure that Lottery products are represented favorably with the public. It is incumbent upon the Lottery to continue to review its business relationship with retailers and to seek ways to improve that relationship through constant refinement of the Lottery's business practices.
- ❖ **GTECH:** GTECH Corporation is the leading global supplier of systems and services for the Lottery industry. The company designs, produces, implements, operates and services computerized on-line networks. GTECH is the Lottery's combined on-line and *Scratch* operations vendor and, as such, plays a critical role in the distribution of tickets, sales tracking, validations of winning tickets and the Lottery's overall integrity and accountability. The company also provides the Lottery with new and revised game concepts, systems modifications, information about other lotteries and assistance with servicing retailers. With its acquisition of Interlott Technologies, GTECH has also become the Lottery's provider of Lottery Product Vending Machines (LPVMs). LPVMs provide player convenience through automated dispensing of *Scratch* tickets from machines that can offer up to 24 different games at one time. In addition, GTECH now offers new functionality that will also allow players to purchase on-line numbers game tickets at these same machines.
- ❖ **Scientific Games Corporation:** Scientific Games Corporation is a world leader in providing a full range of premium-quality lottery products, integrated systems and support services to legally licensed lotteries in more than 50 countries. The company also provides promotional games and related services to companies in the private sector. Scientific Games produces the Lottery's instant (*Scratch*) ticket games. In addition to manufacturing the tickets, Scientific Games provides assistance in game design, production planning and game integrity.
- ❖ **Publicis:** Publicis is an integrated marketing services company that provides the Lottery both advertising and public relations services. Together with the Lottery's marketing function, Publicis plans and develops the creative materials that provide the basis for the advertising that supports games and sales promotions. Publicis also provides media buying services to maximize the distribution and impact of Lottery advertisements and other marketing messages.

Publicis Dialog, Publicis' public relations arm, creates and directs public relations programs for many of the world's leading companies. It provides the Lottery with public relations promotion resources. Publicis Dialog works with the Lottery's

Communications section to develop promotions and events that enhance public education and awareness of Lottery products, programs and accomplishments.

- ❖ **Retailer Associations:** There are four major associations that most often represent the retailers with whom the Lottery has developed strong, productive working relationships. The Washington Food Industry, Washington Retail Association, Korean American Grocer's Association, and Washington Association of Neighborhood Stores are organizations with which the Lottery has engaged in leading the joint development of several major initiatives.
- ❖ **Seattle Seahawks:** The Lottery has a legislative mandate to provide funding for construction of the Washington State Football/Soccer Stadium and Exhibition Center, beginning in 1998 and ending in 2020. Simultaneously, the Seattle Seahawks are mandated to assist the Lottery in generating those funds. To accomplish these goals, the Lottery and the Seahawks have developed a strong partnership that includes joint efforts in creating effective advertising, signage, web site links and banner advertisements; training camp, pre-season, and regular season home game promotions; and sales incentives to support the Lottery's consumer and retailer promotions to launch football-themed *Scratch* tickets.
- ❖ **Seattle Mariners:** The Lottery also has a legislative mandate to provide funding for the construction of the Seattle Mariners stadium beginning in 1996 and ending 2015. Although there is not a mandate for the Mariners to assist the Lottery in generating that funding, the Mariners have helped within the rules of Major League Baseball. Lottery funding amounts are defined in statute.
- ❖ **BLJ Marketing:** BLJ Marketing specializes in lottery marketing research and consulting and assists lottery clients with marketing issues. These issues often include developing, implementing and evaluating market research programs; moderating focus groups; developing products; evaluating progress and profitability; strategic planning; and advertising creative and image development.

Appraisal of External Environment

The environment in which the Lottery operates has been changing quite rapidly and is expected to continue to do so at an even more accelerated pace in upcoming years. General economic factors, player preferences, competitive forces, rapid technological developments and political constraints have profound impact upon the Lottery's ability to generate the maximum amount of net revenues for the State and to respond to the needs and interests of Washington's residents. The Lottery recognizes both threats and opportunities existing in its external environment. The Lottery must be able to adapt rapidly to changing environmental conditions in order to remain competitive and to continue to fulfill its mission.

Lottery Market Share

Most U.S. lotteries enjoyed near-monopoly gaming status during their early years with legitimate gaming competition coming only from resort casinos in Las Vegas and Atlantic City. However, during the 1990s, lottery monopolies began to erode as states permitted other gaming activities to expand significantly. The State of Washington is no different. In fact, the Washington Lottery has more forms of legal in-state gaming competition than most other U.S. lotteries.

In Washington, direct legitimate gaming competition to the Lottery comes in many forms. Twenty tribal casinos offer nearly all the same games that Las Vegas casinos do, including “slot-like” electronic tribal lottery terminals that are virtually indistinguishable from genuine slot machines. Enhanced card rooms, or “mini-casinos” have proliferated in the State since card rooms were authorized to offer house-banked card games. Enhanced card rooms are now second to the tribal casinos in terms of gaming revenue. Pull-tab games, offered in liquor-by-the-drink establishments, generate nearly as much revenue as the Lottery, although pull-tab revenues continue to decline. Traditional card rooms and nonprofit bingo also continue to be alternative outlets for discretionary gaming activity.

Competitive forces are causing significant erosion to the Lottery’s gaming market share. Figure 1 illustrates the shift in gaming market share from 1996 to 2003.

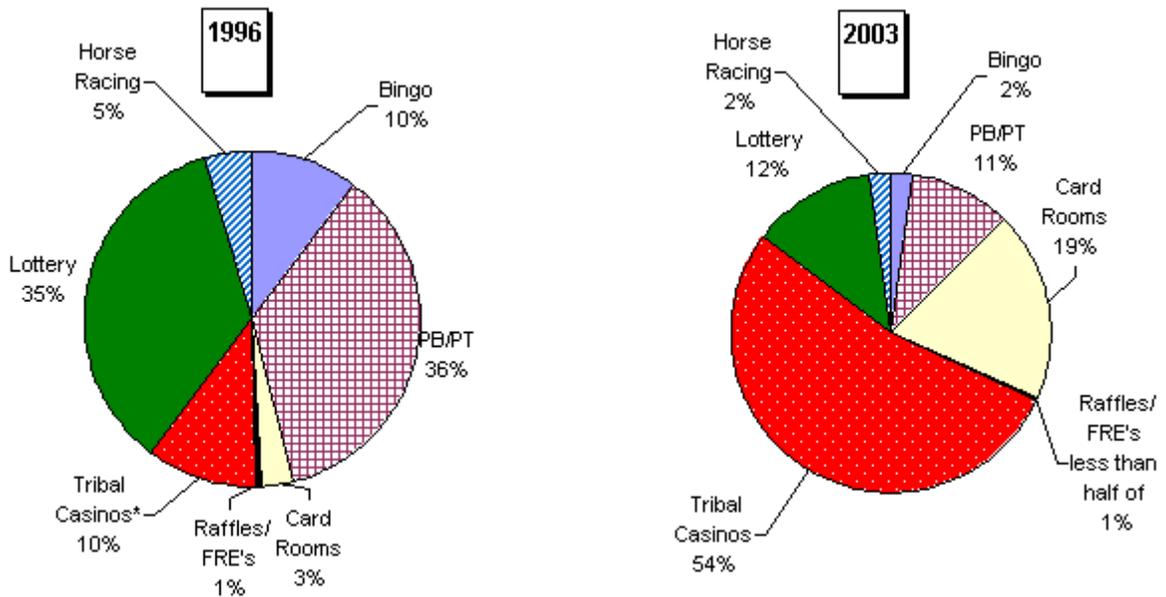


Figure 1: Washington Gaming Market 1996 vs. 2003
 Source: Washington State Gambling Commission

In 1996, the two forms of gaming with the largest share of the Washington gaming market were pull-tabs and Lottery at 36% and 35%, respectively. By 2003, tribal casinos and card

rooms dominated the Washington gaming market with 73% of the share with the tribal casinos holding 54% of the overall gaming market. The Lottery’s share of the market declined to 12%, despite steady sales.

In this same time period, net gaming receipts from all forms of legal gaming increased approximately 275% - from \$476 million to \$1.31 billion. Figure 2 illustrates Washington gaming trends by activity for the 4-year period ending FY 2003. Only tribal casinos and card rooms experienced growth during this period. The tribal casinos experienced double-digit annual growth. The card rooms’ growth appears to be leveling off. All other forms of gaming, including Lottery, experienced steady or declining revenues.

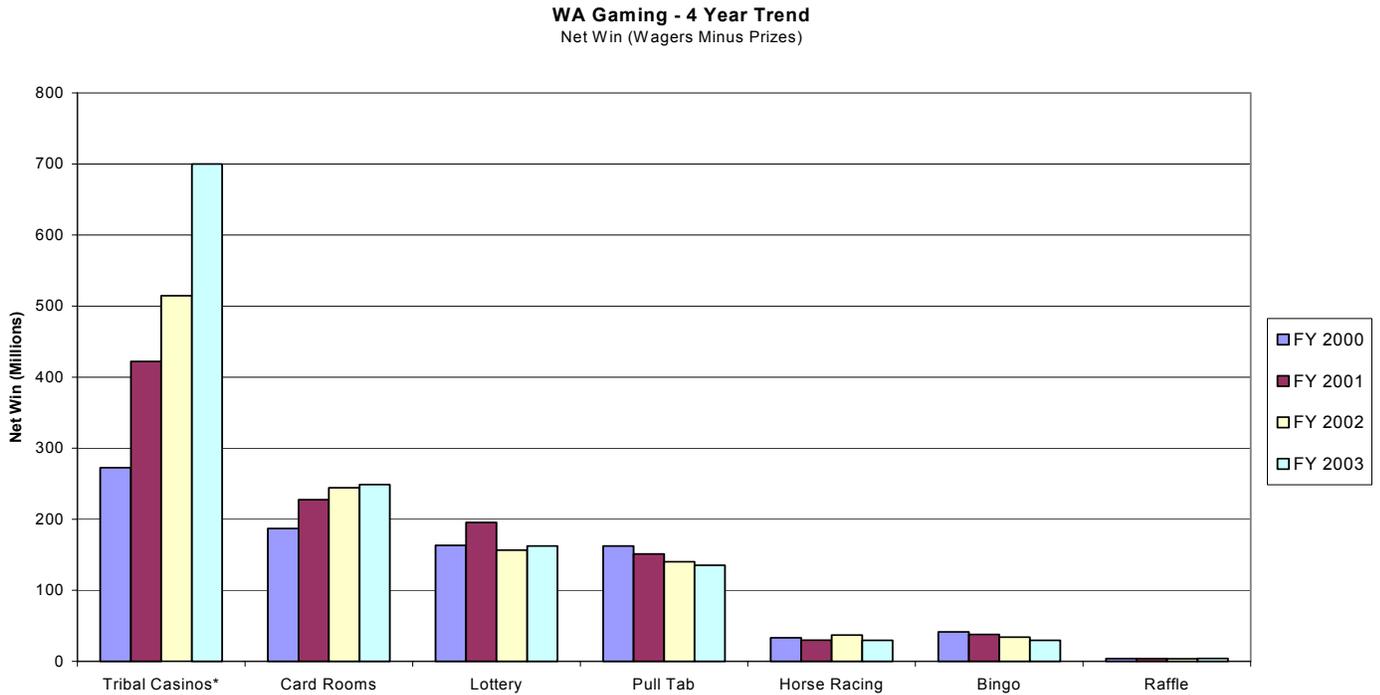


Figure 2: Washington Gaming – 4 Year Trend

The Lottery Value Proposition

During its existence, the Lottery’s customer value proposition, or compelling reasons players choose its games versus competitors’ games, has been rooted in three general areas:

- 1) The ability to offer extraordinarily large sums of money as prizes for a very small wager,
- 2) The convenience of play as Lottery games are nearly ubiquitous in convenience stores, supermarkets and other outlets
- 3) Public openness and accountability with respect to game operations and beneficiaries.

While the Lottery still maintains a competitive edge in these areas, threats to its value proposition are numerous:

- Increasing gaming options – While the Lottery continues to be the only entity that legally offers Washington players a chance to win prizes in excess of \$1 million

(sometimes in excess of \$100 million) for only a \$1 wager, more and more enticing gaming options are being offered to players outside of the Lottery. Tribal casinos regularly offer new and challenging VLT (Video Lottery Terminal) gaming. Internet pari-mutuel off-track horse wagering is now legal in Washington. The Entertainment Industry Coalition continues to apply pressure to extend VLT privileges to include mini-casinos, bingo halls, taverns and restaurants. As outside gaming options expand, the Lottery, with “mature” games and jackpots that fail to excite, will experience flat to negative sales growth.

- Large popular retail chains do not offer Lottery – Popular mass merchandising outlets such as Wal-Mart, Sam’s Club, Costco, and Target do not offer Lottery products. As these chains continue to expand their product offerings into gasoline, convenience items and groceries, they attract demographic segments similar to those of Lottery players – drawing them away from traditional gas, convenience and grocery stores where Lottery products are sold.
- Public Perception – The Lottery has enjoyed public approval ratings of nearly 80% for several years. However, while a recent study indicates that the Lottery leads other gaming entities in public perception as being a “worthy cause” by 47% of Washington citizens, tribal casinos are rated nearly as high by 44% of those same respondents.

Additionally, there are other gaming and entertainment activities that draw attention and activity away from Lottery participation.

- There are currently between 1500 and 1800 active Internet gaming web sites.
- Illegal Internet gaming and legal Internet “pseudo-gaming” offering casino, card and other games can be played directly for money or to build points redeemable for monetary and/or merchandise considerations. Internet gaming is projected to double, growing from \$6 billion wagered in 2003 to a projected \$12 billion by 2006.
- Highly entertaining mobile, home console and computer games offer social and/or competitive features made possible through networked systems. Such capabilities are very appealing to the 18 to 24 and 25 to 34 year old demographics (40% “regularly” participate) – the same demographics that are least likely to play the Lottery (less than one in four are Lottery players). Currently, the Washington Lottery offers no products to engage this age group.

Economic Factors

According to the Office of Forecast Council (February 2004), nonfarm payroll employment hit its lowest level of the past eight years in 2002. Real personal income hit its lowest level in 2001. The Forecast Council projects that the Washington economy will continue to track the U.S. economy in growth, with the steepest growth in both employment and real personal income occurring through 2005. After 2005, employment growth is expected to level off and maintain through 2007. Real personal income is expected to continue to grow past 2005 through 2007, albeit at a slower rate. In addition, disposable personal income is expected to increase at approximately 5% per year through 2007.

As the Lottery competes with other entertainment activities for personal disposable income, this is an encouraging sign. No decline in Lottery sales is expected as a result of the expected economic conditions through 2007.

E-Commerce Drivers

Seventy percent (70%) of Washington players access the Internet at least one hour each week for personal or business reasons. Of these players, 45% have made at least one Internet consumer goods purchase within the last six months. The Internet provides easy access to information and allows purchases and other transactions to be made very conveniently.

The full extent to which state lotteries may leverage this technology remains unclear as federal legislation is still pending regarding the use of the Internet to conduct gaming transactions. Within the past year, some U.S. lotteries have taken tentative steps to add an Internet enhancement to the play experience with some selected games. In addition, some states are moving to capitalize on mobile communications technology to enhance games.

Despite these recent attempts, lotteries lag private industry and even other public sector agencies in their capabilities to provide electronic customer service for both players and supply chain partners. As more and more people assimilate the e-commerce into their daily lives, expectations regarding the utility of electronic capabilities are continually rising. The Lottery will not be immune to these high expectations.

Among other things, e-commerce technology is currently being used to facilitate supply-chain management, inventory management, new product development, market research, consumer transactions, account management and loyalty programs as well as providing general company information. E-commerce innovators have gained market share through the enhancement of services that extend beyond the capabilities of “bricks-and-mortar” operations - delivering more information and control to consumers at their own desktops. In addition, the same technology has been used to deliver more timely intelligence back to companies so that shifts in consumer behavior are more readily identified and responded to.

The Lottery must soon be able to identify and assimilate those aspects of the technology that it needs to accommodate the growing sophistication of the demands of the marketplace or risk the long-term loss of customers – particularly those within the 18 to 34 year old age range. Additionally, the Lottery must be prepared to meet initial resistance, political and otherwise, in order to make the advances that it will need to stay competitive.

Industry Trends

Like Washington, state lotteries in the U.S. are continually attempting to maximize revenues through game enhancements and other promotions. Also like Washington, most of the games offered by state lotteries are either *Scratch* tickets or number drawing games (e.g., *Lotto*). These gaming options have, for the most part, reached maturity in their product life

cycles. To combat stagnating sales, lotteries have been gradually increasing the prizes paid out on *Scratch* tickets. To combat slow jackpot growth (“jackpot fatigue”) with their own *Lotto*-type jackpot games, all but three lottery jurisdictions have joined a multi-state jackpot game (*Mega Millions* or *Powerball*) to achieve higher jackpot amounts than could be achieved on their own. These changes have improved sales and profits, but many states are faced with fewer options remaining to enhance their current product lines.

Unlike Washington, there are a number of states that offer lottery gaming options beyond the “traditional” *Scratch* ticket and numbers games.

- Several states have had successful revenue increases by offering multiple daily draws of existing games. Many states now offer several three-, four-, and five-digit game draws per day. *Legislative approval is required for the Washington Lottery to offer more than one drawing of any of its numbers drawing games per day.*
- Twelve lotteries, including neighboring Oregon, offer multi-draw Keno every four or five minutes. Michigan, beginning in FY 04, is the state most recently approving the game. Multi-draw *Keno* has been a strong revenue generator in the states that offer it. *The Washington Lottery must have legislative approval to offer its Keno game in the form of the more successful multi-draw Keno format.*
- New York became the sixth U.S. lottery to offer Video Lottery Terminal gaming. Though controversial, VLT gaming generates large revenue amounts and is being considered by additional states as a potential lottery revenue option.

Though federal and state laws still remain unclear with respect to the legality of state lottery electronic play, several lotteries have begun to introduce computer, Internet and/or mobile phone enhancements to their product lines. The New Jersey Lottery offers CyberSlingo where a *Scratch* ticket is purchased at a retail location. The player scratches the latex to reveal a code that can be entered on a web site. The player can interact with a computer-enhanced play experience that results in a winning or non-winning experience. The Kansas Lottery will debut eScratch where an on-line ticket is purchased at a retailer. The player chooses the amount of the purchase and enters a web site that gives a variety of different games that can be chosen for the play experience. The Iowa Lottery is test marketing an electronic liquid crystal display-based ticket that offers a unique play experience. Several other lotteries are planning new products that will leverage Internet and other electronic technologies to create new and unique lottery experiences.

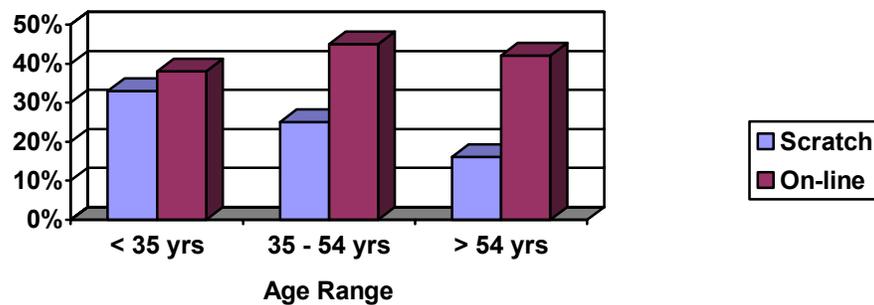
International lotteries already offer fully functional Internet purchase and wagering account management. Although the U.S. law is unclear at present, the expectation is that ultimately U.S. lotteries likewise will leverage networking technology to remain competitive with other gaming and expand their market shares. The Washington Lottery must be prepared technologically, creatively and procedurally to take advantage of newly available technological channels to its players.

Trends in Customer Characteristics

Accompanying the proliferation of gaming in Washington and the growth of the Internet are shifts in Washington Lottery player habits. Traditional lotto-type numbers (on-line) games with drawings once per day or less frequently have historically been more popular with casual players than the Lottery's *Scratch* games. On-line games rely primarily on jackpots to appeal to players, whereas *Scratch* games attract more consistent and loyal play with their instant-win features and varied themes and play styles.

More recently *Scratch* game revenues have overtaken those of on-line games. The chart below indicates a generational shift that helps explain this trend. While the Lottery's on-line games are very popular with Baby Boom and older generations, they are less so with younger players. Conversely, *Scratch* tickets are much more popular with younger players than with older players.

Lottery Game Play in the Past 3 Months by Age Group



Research shows that younger players find on-line games with their relatively infrequent drawings to be dull. They prefer gaming that provides more challenge, immediate feedback and gratification. This phenomenon is consistent with current cultural and technological trends. This age group tends to expect immediate accessibility to the things that they enjoy. Waiting and/or depending upon others is not an option. They also prefer to be more self-reliant and desire more control with respect to the media through which they engage themselves. This age group represents the players of the future. It is important that future Lottery games be able to respond to and satisfy the demands of these and upcoming generations of players.

Customer Trends – Current Games

The Lottery manages its mix of games in two separate product lines, distinguished by the nature of the payout: instant wins, where predetermined winning/non-winning numbers are packaged into the tickets as part of their design and construction process, and drawing wins, where winning numbers are not known at the time of sale but are produced by a random draw at a specified future time.

<p>Numbers drawing games (On-line) – The Lottery’s most recognizable product line accounts for 43% of its sales. Six different drawing games are available with top prizes that range from as little as \$250 to several hundred million dollars. The games offer either fixed or rolling (jackpot) prizes or a combination of both. Three games are drawn daily and are made up of loyal core players and few “casual” players. Three jackpot games are drawn twice per week, and, though they too have a loyal player base, these games are most likely to be played by less involved players. These “casual” players typically play only when jackpots become very high.</p>	<p>Instant ticket games (Scratch) are the Lottery’s second most recognizable product. Its players, though fewer in numbers, play much more consistently than do players of other games. <i>Scratch</i> accounts for 57% of the Lottery’s total product sales - despite a player base that is about half that of all the on-line games combined. Its variety of pricing options, top prizes, and themes along with its instant-win feature make it very appealing to younger players.</p>
<p>Lotto continues to be the Lottery’s flagship game. It has the largest player base (43% of Washington residents are players). It is the most identifiable of our product mix (98% of residents are aware of the game) and it has received the most play (68% of residents have played <i>Lotto</i> at least once). Awareness and playership of <i>Lotto</i> remains high despite two major changes to <i>Lotto</i> in the past two years and the introduction of a multi-state game (<i>Mega Millions</i>) that offers significantly higher jackpots. <i>Lotto</i> is not popular with younger players – half of Washingtonians under 35 have never played it. Because <i>Lotto</i> jackpots were redesigned to manage costs better, jackpots increase at a slower rate. As a result, <i>Lotto</i> sales are expected to decline with time.</p>	<p>“Money” Games – one of the most successful instant ticket themes. <i>Gold Mine, The Money Game, Hit \$50, \$1 Million Extravaganza, Money Storm, \$50 Grand, Triple Cash, Green and Gold, S'more Cash, \$250,000 Cash Spectacular, Power Card, Hit \$25, Green Stuff, Jackpot Gold, Cool Million, Sunny Money</i></p> <p>“Numbers” Games – also among the most successful instant ticket themes. <i>Fabulous 5s, Triple Sevens, Fun 1s, Super 6s, 7-11-21, Ruby Red 7s, Winning in 3s, Double Wild 7s, Casino 7s</i></p>
<p>Quinto sales are strongly tied to <i>Lotto</i> sales. Sales have declined rapidly since FY01 (dropping nearly 50% from ~\$41M in 2001 to a projected \$21M in 2004). Because of its decline, <i>Quinto</i> profitability has declined as well. Younger players and casual players do not play <i>Quinto</i>. <i>Quinto</i> is an immediate target for redesign.</p>	<p>Licensed Games – produced via partnerships with popular businesses, these games generally perform very well. <i>Tabasco, Trucks & Bucks, Slingo®, The Price Is Right™, Slingo®, Pink Panther™, Betty Boop, NBA</i></p>
<p>Mega Millions sales have not lived up to the expectations surrounding it when it was first introduced. The game was introduced immediately following the unpopular change of <i>Lotto</i> to <i>Lotto Plus</i> and jackpots averaged approximately half of the amount expected statistically. As a result, brand recognition, awareness and playership were very low for a</p>	<p>Bingo and Crossword Games – these games have loyal followings, are extremely popular. <i>Diamond Bingo, Free Spot Bingo, Crossword</i></p> <p>Luck Games - these games use the “luck” theme. <i>Lucky Penny, Struck By Luck</i></p>

<p>game format that was a demonstrated success in other lottery jurisdictions. Since Texas joined the <i>Mega Millions</i> game in 2nd Quarter 04, jackpots have averaged higher for the game, including a record \$230M Jackpot In February 04. Since then, base <i>Mega Millions</i> sales have risen along with playership. As jackpots reach higher levels, there is a greater chance that <i>Mega Millions</i> will continue to solidify its brand recognition among Washingtonians.</p>	
<p><i>Lucky for Life</i> sales have declined every year since its introduction. New players no longer try this game. Because of issues with profitability and low sales, <i>Lucky for Life</i> is a candidate for redesign.</p>	<p><u>Seasonal/Sports</u> Games – seasonal games are very successful, sports games moderately so. <i>Red Hot & Blue, Holiday Green, Doughman Doubler, Winter Ice, All Stars, The Back 9</i></p>
<p><i>Daily Game</i> sales, though relatively low, have been very consistent with a unique core of players. <i>Daily Game</i> players are least likely to engage in other Lottery game play. Most new players come from the Eastern U.S. where the game has a much stronger cultural foundation.</p>	<p>“Whimsical” Games – these games use fun and humor to appeal to customers. <i>Snake Eyes, 20 Sows & Bucks, Music Cats, Leprechaun Loot, Spring Fever, Tons of Fun, Cash on the Cob, Chomp Change, Zodiac Cash</i></p>
<p>Single-draw <i>Daily Keno</i> is unappealing to players. Games sales continue to erode steadily. To change <i>Daily Keno</i> to a multi-draw version, a proven success in other lottery jurisdictions, legislation must be enacted.</p>	<p>Gaming Games – these games use a casino theme. <i>Super Mega Slots, Silver and Gold Slots, Crazy Aces</i></p>

Strategy and Capacity Assessment

Effects of civil service reform and contracting out on Lottery operations

The impact of upcoming Washington State government reforms on the Lottery promise to be significant. Human Resources staff are currently challenged with preparing for reform, and will continue to be challenged with its implementation, which will result in new rules, new job classes, a new payroll system, at least one more labor contract, a new job classification process, a new employee evaluation process, and the shift of responsibility in the areas of recruiting, salary setting, promoting, and performance management.

While larger agencies will likely divide and delegate these areas of expertise across their larger HR staffs, the Lottery’s limited human resource staff will need to absorb and implement the entire package of changed practices – all the new knowledge - themselves. Additionally, attending to employee morale issues and fear of the unknown will require deliberate and adept change management practices.

Reforms are challenging in and of themselves, but the Lottery has approximately 30 employees who will be eligible to retire by December 2005. The potential of a 20% turnover occurring at the same time civil service reforms start up is a sobering prospect.

□ To ensure smooth succession for positions being vacated by retirement, ideally we would establish “bridging” FTEs. These double-fill positions will allow staff to keep daily operations going while successors are being trained to fill vacated positions.

Workload and turnover issues aside, there may also be unknown costs to the Lottery for its share of the cost of developing and installing the new HRMS system. No money was been budgeted in FY05 for this possibility.

Planned shifts in technology strategies

□ The Lottery plans to change its on-line gaming vendor contract. This will undoubtedly involve impacts to technology, although exact changes are unknown at this time.

□ The Tandem, the core of Lottery’s operation as well as the Quality Control center for the current on-line vendor, requires another upgrade.

□ In addition, the Finance and Administration Division requires a new business accounting system.

Service delivery methods

There is both a need and opportunity for shifts in service delivery methods. The Lottery’s mission is to generate revenues for the state. The agency has a responsibility to explore every opportunity to grow sales and provide great customer service. Keeping pace with new technologies and expanding into non-traditional tradestyles are a must if we are to succeed.

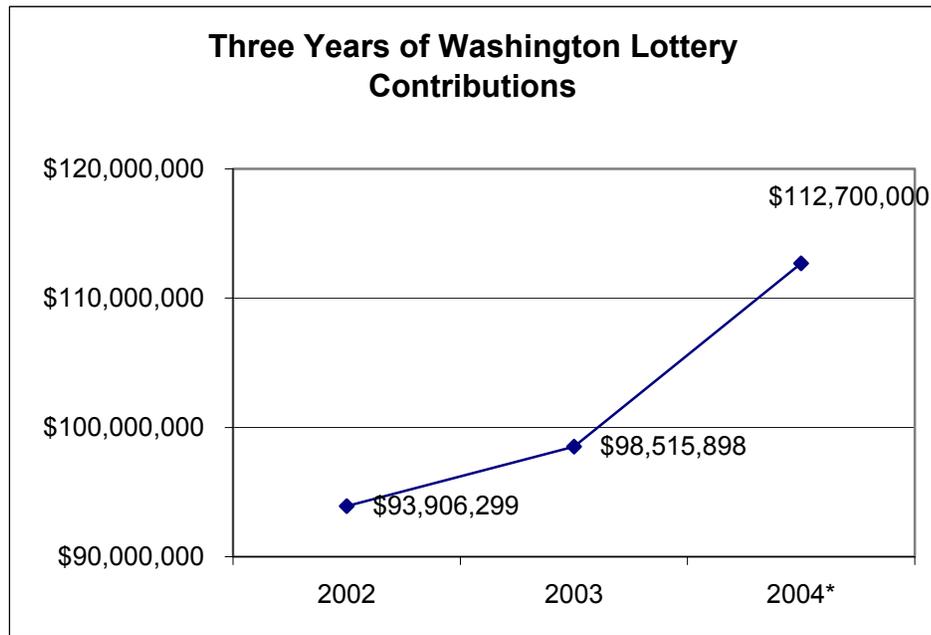
The Lottery needs to maintain its core players, and expand its player base. The current product mix is essentially unchanged, resulting in flat to declining sales projections and, thus, diminished contributions to the state's funds. Increasing quality and quantity of products through innovation is paramount to continued success.

In the next biennium, the Lottery will explore new games and new technologies for our players to use, such as mobile devices, PDAs, and interactive web-based games. The agency will also pursue selling its products in untapped tradestyles such as coffee houses, home improvement stores and airports. Additionally, the Lottery will continue to seek ways to make checking tickets more convenient for players, such as entering numbers or a code on the Lottery web site. Any of these ideas will impact service delivery.

Providing easier access to Lottery products, developing exciting games that appeal to a broad-range of players, and implementing cutting-edge technology are good business

decisions that will help the Lottery stay competitive resulting in increased revenues for the state.

Performance Assessment



*Estimated

In FY04, actual performance in both sales and in beneficiary contributions has exceeded year-over-year sales and projections. On-line games are primarily jackpot driven, and jackpots have been higher on average than in recent years. Jackpot size is a random occurrence and vary from year to year, so on-line product sales must always be predicted with caveats. In addition, the financial structure of the new *Lotto* game is more solid, avoiding the risks associated with the structure of the game it replaced, *Lotto Plus*.

Higher price points for *Scratch* games contributed to higher revenues in that product line. While higher prices were a natural evolution for instant tickets, simply enlarging tickets, prizes, and prices is not a strategy that can operate forever. The novelty of higher-priced tickets is being carefully monitored.

While per capita sales of lottery products in Washington rank in the bottom third of U.S. lottery jurisdictions, Washington per capita sales are quite comparable to those of other Western U.S. states. Lottery play in the Eastern U.S., in general, is much more routine for residents; whereas in the Western U.S. lottery play tends to be more “casual” – players do not play as ritualistically. The table below compares Washington Lottery per capita sales to other Western lottery jurisdictions (exclusive of Keno and Video Lottery).

State	FY 2003 Per Capita Sales
Colorado	\$86.02
California	\$78.39
Washington	\$75.08
New Mexico	\$73.09
Idaho	\$71.85
Oregon	\$68.40
Arizona	\$57.75

Financial Health Assessment

At this time there do not appear to be any significant trends in revenue sources or any fund balance changes.

We foresee upward pressure on the amount of commission paid to the on-line vendor. The commission is currently 2% of sales and is likely to rise with the new contract due to inflation, the cost of the new technologies, and an expanded retailer base. This cost will have a direct impact on Lottery profit margins.

Strategic Assessment

Risks, Obstacles and Opportunities

Operating in a gaming environment experiencing radical shifts, the Lottery is especially vulnerable to risks at this time.

- **Continued loss of market share**
 - 35% market share in 1996 was down to 12% in 2003, due primarily to the rapid growth of tribal casinos and mini-casino gaming.
- **Initiatives further eroding Lottery market share** (e.g., Eyman/VLT Initiative)
 - Proposes to allow private casinos, etc., to advertise and sell attractive “electronic scratch tickets.” Approval would give a major advantage to competitors and cannibalize *Scratch* revenue currently contributed to Lottery beneficiaries. The return to the state would be significantly less than if the Lottery managed VLTs on its own.
- **Initiatives or bills targeting specific Lottery budgets** (e.g., the Problem Gambling Initiative)
 - Proposes taking \$500,000 from the Lottery advertising budget.

- The Lottery already contributes approximately \$509,000 to problem gaming activities, the majority of which is in-kind public service announcement via print, television and radio.
- Conservative studies show lotteries experience a 9-fold sales benefit from advertising. With a \$500,000 reduction in advertising, annual loss of Lottery sales is estimated at \$4.5 million. Estimated annual loss of revenue to education: \$1.35 million.
- **Rapidly changing customer profiles and buying practices**
 - Nearly 60% of all adult home users purchased goods and services on-line in 2003.
 - In the last year, the number of people who have reduced their ‘in-store shopping’ since having purchased something from the Internet grew from 53% to 66%.
 - Younger Washingtonians are least likely to have played any Lottery on-line numbers drawing games (only 52% of 35 and under individuals have played *Lotto* while 72% of those 35 and older have).
- **Internet gaming cannibalization**
 - Approximately 82% of Internet gamblers are between the ages of 30 and 59 (the core age range for lottery players).
 - Similarly, most Internet gamblers earn less than \$100,000 annual household income (similar to lottery players).
- **Core players aging**
 - Median age of Washington Lottery players has increased from 44 in 1999 to 49 in 2003.
- **Permanent loss of 18 – 24 demographic**
 - In 2003, 18- to 24-year-olds represented 13% of Washington’s population, but only 6% of the Washington Lottery’s players (down from 9% in 2000).
 - The most frequent reason for not playing the Washington Lottery by 18 to 24 year olds is that “It’s boring.”
- **Legislators and/or Executive Branch staff lacking sufficient technical and market information to make the best decisions for beneficiaries**
 - Mobile device technology
 - Scope of Internet gaming
 - Effects of competition on revenue and contributions to education
- **Aging product lines**
 - *Scratch* tickets have been offered by the Lottery since 1982.
 - On-line games have been offered by the Lottery since 1984:
 - *Daily Game* – 20 years
 - *Lotto* – 19 years
 - *Quinto* – 14 years
 - *Daily Keno* – 12 years
 - *Lucky for Life* – 6 years
 - *Mega Millions* (multistate) – 2 years
- **Inflation**
 - Based on the Consumer Price Index, 2004 dollars are worth only 89.5% of what they were worth in 1999

- The Lottery's sales and transfers have remained relatively flat during the past 5 years, with transfer profit hovering around \$100 million each year. Without any product additions or growth, the Lottery's net returns are not expected to change significantly. Assuming an annual inflation rate of 3% over the next 5 years, the Lottery must return \$116 million in 2009 to provide the same purchasing power as a return of \$100 million in 2004.

Risks, Obstacles and Opportunities

- Political sensitivity surrounding games of chance
The gaming spectrum, running as it does from casual entertainment to serious gambling, is especially prone to "slippery slope" thinking by regulators.
- No single, popular beneficiary or beneficiary program to garner public loyalty
Unlike many lotteries (South Carolina Education Lottery, etc.), the Washington Lottery cannot claim that its contributions go directly to a single, popular beneficiary or defined beneficiary program such as college scholarships. The result is a lost opportunity to generate player loyalty and thus, increased revenues. Many Washingtonians tell staff that they would play or play more if they could see their money was going directly to education.
- No standardized industry accounting practices.
U.S. lotteries all use their own unique accounting systems, creating a barrier to establishing traditional business arrangements with the large, interstate retailer markets such as Target, Wal-Mart, etc.
- Complex and proprietary nature of vendor systems
Lottery vendors' data formats and processes are proprietary, so moving from one vendor contract to another requires time-consuming conversions. The complexity of these systems reduces flexibility and/or generates lengthy delays in meeting Lottery customer needs.
- Inflexible state accounting system
AFRS operates on a fund accounting system while the Lottery must operate on an enterprise accounting system. Consequently, input and output to AFRS requires a great deal of staff time, and the output is not frequent or detailed enough to be useable. Separate spreadsheets must be maintained in order to provide input and then AFRS output would again have to be modified to meet Lottery needs. In addition, the Lottery close its books annually while AFRS does so only biennially, creating an even more complex interface between the two sets of data.
- Growing public reluctance to telephone polling
Recent overwhelmingly negative public response to telemarketing practices positions the public to resist one important means of collecting customer data: telephone polling. The balance between the Lottery's need to understand its customers and the Lottery's need to maintain public good will has shifted away from research.
- Public misunderstanding of "where the money goes"
 - Only 31% of Washingtonians know that proceeds from the Lottery can and do fund Washington education.

- A full 8% of the population say the money should be going to education but doesn't.
- Loss of revenue to Internet gaming
The explosion of Internet gaming has created a major market in which the Lottery is prevented from participating. This vast and unregulated industry siphons off millions of dollars to uncontrolled entities. Lotteries, which benefit the public and are transparent in their operations, have no government protection from this competition.

Risks, Obstacles and **Opportunities**

- Raising an additional \$250 million in revenues through the introduction of VLTs
- Specifying a direct, singular beneficiary with broad public appeal, such as conservation or educational scholarships
- Opening new markets with proven Lottery games such as multi-draw Keno
- Expanding retailer network by offering a variety of hardware solutions and/or business agreements (e.g., leased "footprints" instead of commissions)
- Installing full-service (both *Scratch* and on-line) product vending machines
- Enhancing vending machines and self-service Lottery terminals to permit customers to make electronic cash payments
- Electronic extended play enhancements or add-ons to existing products
- Selling Business-to-business (bulk sales, fundraising, recognition packages, etc.)
- Conducting on-line focus groups, surveys, other research
- Expanding use of networked systems (Internet, mobile gaming, interactive television)
- Using networked systems for 2nd chance drawings, online verification of winning tickets, database marketing, coupon promotions, etc.
- Moving to a privatized or quasi-privatized business model
- Enhancing sales and player tracking capabilities
- Advanced deposit wagering and remote player account management similar to recently approved horse racing wagering model.

Internal Resource Assessment

Workforce and work systems

In the Lottery's February 2004 Agency Self-Assessment, participants identified a relevant strength that can be leveraged for success: customer feedback systems (*score: 6 of a possible 7*). General data quality is also strong (*score: 4 out of 7*). At the same time it was noted that customer-focused results – improvements in customer service as a result of acting on feedback data – usually cannot be demonstrated (*score: 2.5*)

Participants felt inadequately equipped in the use of quality tools to monitor and improve processes (*score: 2*). Few processes have been documented or analyzed for process improvements (*score 2.5*) while, at the same time, work teams regularly look for new ways to meet customer needs (*score 4.5*). Cross-functional support process improvement teams are rare (*score: 2.5*) although partners and suppliers are commonly engaged in new key business processes (*score: 5*) and the supplier relationship is strong.

Participants concluded that, along with the above noted opportunities, increased coaching, recognition, and use of trend data would increase employees' ability to succeed.

Washington Lottery Long-Range Strategic Plan

► INSPIRE EMPLOYEES

▲ Enhance Development

- Improve the quality and quantity of 360° feedback.
- Reassess the physical work environment.

▲ Enhance Internal Communications

► OPTIMIZE SALES

▲ Develop new products and markets

- Establish new means of product distribution (tradesyles, equipment, other).
- Initiate a comprehensive research program that investigates non-accessed markets.
- Review statutory regulations for capability or for needed changes.
- Target small independent chains for early trials.
- Leverage vendors to sell in to new markets.
- Initiate electronic gaming (Internet, wireless, cable, etc.).
- Assess and act on opportunities for interagency sales.
- Assess and act on opportunities for inter-business sales.
- Allow for multiple drawings per day on any/all games.

▲ Capitalize on new technology

- Conduct ticket integrity testing in-house.
- Look at other industries to see how/what technology they use.
- Develop the new gaming system.
- Design new *Scratch* RFP defining *Scratch* as an instant product.
- Refresh electronic infrastructure (Tandem).
- Pay winners with debit cards.
- Sell loyalty cards with scannable messages.
- Install a modern business/accounting system.

▲ Enhance productivity

- Develop incentives for all staff.
- Develop flexible retailer commission structures.

► MAXIMIZE PUBLIC VALUE

▲ Expand Effective Communication

- Target specific stakeholder groups with customized messages.

Cost Reductions and Efficiencies

Achieved

The Lottery continues to reduce costs and achieve efficiencies where possible. Over the last several years, the organization has

- converted manual accounting procedures to automated systems, including the processing of winners' annuity checks and the processing of payments to vendors, thus reducing the time required to complete the tasks and also the chances for human errors.
- automated the customer notification process in Purchasing, including field orders and credit card purchases, eliminating the need to manually notify internal customers that their field orders or credit card purchases have been processed.
- moved to electronic forms, reducing the need to print and store paper forms.
- developed an integrated FedEx label for ticket shipments, relieving warehouse staff of the necessity of handling outgoing FedEx shipments twice.
- developed an in-house method for printing W2G statements.
- implemented the Executive Information System, a web-based compilation of all Lottery sales and retailer data.
- avoided increased ticket distribution costs by changing to a lower-cost courier.

Planned

In the next biennium or sooner, organized cost reduction and/or efficiency efforts are planned for the following processes:

- Route management (for Lottery's sales representatives)
- Personal technology device assignment (cell phones, PDAs, laptops, pagers, etc.)
- Advertising and print material production
- Merchandise and promotional materials purchasing
- Policy development and implementation
- Office space and equipment consolidation
- Production of CAFR (Comprehensive Annual Financial Report)
- Assignment of agency vehicles
- Expansion of EFT (Electronic Fund Transfer) practices
- Revision of research practices to allow for master contractual agreements

Alternative Strategies

The Lottery has examined two revenue generating product strategies that have been proven to be successful in other U.S. lottery jurisdictions and that can be brought to market fairly quickly:

- Video Lottery Terminals. Six states offer video lottery. Three offer it at racetracks only, two offer it in age-controlled liquor-by-the-drink establishments and one offers it at both types of locations. Video lottery is the largest generator of lottery revenue in all states that offer it, returning one hundred to several hundred million dollars in income to their respective jurisdictions each year.
- Multi-draw (or “quick draw”) Keno. This game is offered in 12 U.S. lottery jurisdictions. With drawings every four or five minutes shown on monitors, this game is very popular in liquor-by-the-drink establishments and other social settings. While it does not generate the high levels of income that VLTs do, multi-draw *Keno* is a solid revenue generator – providing even the lowest population states tens of million dollars of additional lottery revenue.

The Washington Lottery believes these product strategies to be viable revenue generating sources for Washington as well; however, the Lottery is not pursuing these strategies at this time. Because the Lottery recognizes that both strategies can generate considerable revenue quickly, the organization continues to assess the viability of moving forward on these strategies.



Washington Lottery Marketing Plan Fiscal Years 06-07

The Lottery's marketing plan over the next several fiscal years reflects the business reality of just about every enterprise in the world:

- keeping current consumers loyal purchasers of our products
- reaching out to new consumers and new trade styles, expanding playership and increasing per capita spending.

The challenge is to capture the attention of new consumers without losing the sales of our core consumer base.

The Lottery's Marketing Plan theme is Momentum and Innovation. Momentum is about keeping our current consumer base interested in the products and promotions offered by the Lottery. Innovation is about capturing the interest of new consumers with products and promotions that are so exciting that even the hard-to-attract young adult market sits up and takes notice! Together, a blend of Momentum and Innovation will help the Lottery generate revenues for vital education programs.

Looking forward to Fiscal Years 06, 07 and beyond, competition in the marketplace is a considerable barrier to increased Lottery revenues. Casinos and card rooms spend significantly more for advertising and media than the Lottery. These venues offer products that the Lottery currently cannot offer: exciting *interactive* games. In addition, the Lottery also sees entertainment products in general as competition. Consumers have limited resources to spend on entertainment products such as mobile devices, console games, movies, soft drinks, and other products intended to provide consumers with a "break" from their busy lives.

Given that Education is the key beneficiary of Lottery proceeds, the Lottery would like to encourage every adult in the state to purchase our products. Being realistic, the Lottery must assess key demographic markets within the state in order to

- 1) determine which markets are underserved and
- 2) promote or develop products with these underserved markets in mind.

This requires a constant focus on our core consumer – and a focus on innovative products for the new consumers.

The young adult market (18-24 year-olds) is a key market the Lottery intends to pursue – this market is favorable towards the Lottery (81% report a positive attitude toward the Lottery) and is currently underserved by the Lottery’s existing product mix.

To serve these new consumers, the following principles and applications must apply:

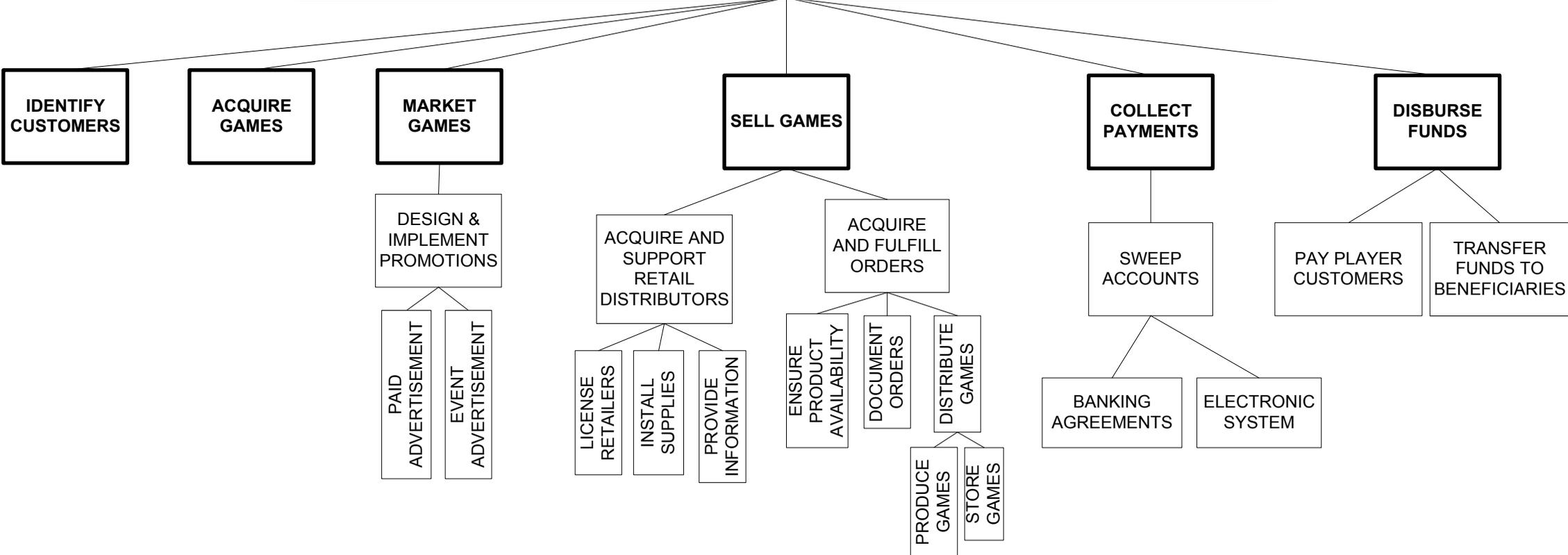
- The Lottery must remain competitive with our product offerings.
 - Interactive games that allow players to play wherever and whenever they want will be key.
- Our society is increasingly mobile – and increasingly busy.
 - The Lottery must be accessible to our players wherever they find themselves (not just when they happen to be in a convenience store or supermarket).
- Specific products, in traditional Lottery language, requiring consideration are:
 - Multi-draw *Keno*
 - Computer-based games
 - Video Lottery Terminal
 - Mobile games.

Throughout Fiscal Years 05, 06, and 07 the Lottery intends to implement new products and promotions that use new technology.

The Marketing Plan for Fiscal Year 06, 07, and beyond will focus on all of these realities. Our share of the gaming market decreases every year. Money that could be directed to Education programs is instead going to card rooms, tribal casinos, and pull-tab operators. We must focus on bringing our market share back in line, attracting new consumers, and introducing new products that will generate increased revenue for vital education programs.



SUPPLEMENTING REVENUES THROUGH THE SALE OF GAMES



- Support operations
- UNDERSTAND CURRENT AND FUTURE MARKETS
 - PLAN FOR FUTURE VIABILITY, COMPETITIVENESS
 - BUDGET FOR OPERATIONAL CAPABILITY
 - ACQUIRE FACILITIES, EQUIPMENT, MATERIALS
 - FACILITATE OPTIMAL STAFFING
 - MAINTAIN CONTINUOUS IMPROVEMENT
 - FINANCE VENDORS, COMMUNICATION CHANNELS
 - SECURE INFORMATION, STAFF, OPERATIONS
 - MAINTAIN, ASSETS
 - MONITOR COMPLIANCE WITH RULES, LAWS
 - MANAGE PUBLIC COMMUNICATION

