



Lottery Profits Are Slowing with Economic Downturn; Advertising Services and Retailer Commission Rates Need to Be Addressed

at a glance

In Fiscal Year 2007-08, growth in Lottery transfers to the Educational Enhancement Trust Fund began to slow. Current forecasts indicate continued slowing of revenue growth and education transfers due to current economic conditions. To address this challenge, the Lottery launched Powerball, a multi-state jackpot game, and is continuing efforts to expand its retail network and multi-priced online games.

The Lottery's operating expense rate is among the lowest in the nation but its administration costs continue to rise due largely to growth in commission payments. To address this issue, the Lottery has changed its scratch-off ticket vendor payment structure to reduce these costs but should further adjust commissions for higher-priced tickets and change its retailer payment structure. The Lottery has renegotiated the lease for its headquarters but continues to lease excess office space. The Lottery could realize additional efficiencies by evaluating its retailer recruitment process and the department should take steps to improve its marketing evaluation and competitively secure advertising services.

Scope

The Joint Legislative Auditing Committee directed OPPAGA to examine the Department of the Lottery and identify options to enhance its earning capability and improve its efficiency as required in s. 24.123, *Florida Statutes*.¹ Our report also tracks the Lottery's implementation of prior OPPAGA recommendations made in previous annual reports.²

Background

Following voter approval of a constitutional amendment, the 1987 Legislature enacted the Florida Public Education Lottery Act. The act created the Department of the Lottery to generate funds for education and to enable the state's citizens to play state operated lottery games. The Lottery is headquartered in Tallahassee with nine district offices (Exhibit 3, page 4, shows the location of the district offices).

¹ Section 24.123, *F.S.*, requires an annual financial audit to include recommendations to enhance the earning capability of the state lottery and to improve the efficiency of department operations.

² *Lottery Profits Continues to Increase; Options Available to Enhance Transfers to Education*, Report No. [08-19](#), April 2008; *Lottery Scratch-Off Sales Increase; Options Available to Enhance Transfers to Education*, Report No. [07-09](#), February 2007; *Florida's Lottery Responding to Revenue, Efficiency, and Minority Retailer Challenges*, Report No. [06-04](#), January 2006; *Lottery Faces Challenges Meeting Future Revenue Demands, Continues Work to Improve Efficiency*, Report No. [04-80](#), January 2004; *Progress Report: Florida Lottery Makes Progress By Implementing Many Justification Review Recommendations*, OPPAGA Report No. [04-01](#), January 2004; *Justification Review: Sale of Lottery Products Program*, OPPAGA Report No. [02-11](#), February 2002.

The Lottery generates revenue from the sale of both online and scratch-off tickets. The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2008-09, the Legislature appropriated \$163 million and authorized 440 positions for Lottery operations.

Since its inception, the Lottery’s core functions to produce, advertise, and sell tickets have been outsourced to retailers and private vendors. The Lottery contracts with a wide range of retailers such as supermarkets, convenience stores, gas stations, and newsstands to sell online and scratch off tickets to the public. Retailers receive commissions for selling lottery products at a rate of 5% of the ticket value in addition to a 1% bonus for redeeming winning tickets.

Beginning in January 2005, the Lottery entered a six-year contract with GTECH, its online gaming system vendor, to provide computer systems, retailer terminals, software, telecommunications, and technical support services. In October 2008, the Lottery entered a six-year contract with Scientific Games to print and distribute scratch-off game tickets through September 2014. The Lottery’s Hispanic-market advertising contract with Zubi Advertising expired on June 1, 2008, whereupon the department signed a three-year contract with Machado Garcia-Serra Advertising,

Inc., for these advertising services. On June 30, 2008, the department’s major advertising contract with Cooper DDB expired. The department is currently operating on a month-to-month basis with this vendor and reports that the procurement process will be concluded and a new contract in place by May 2009.

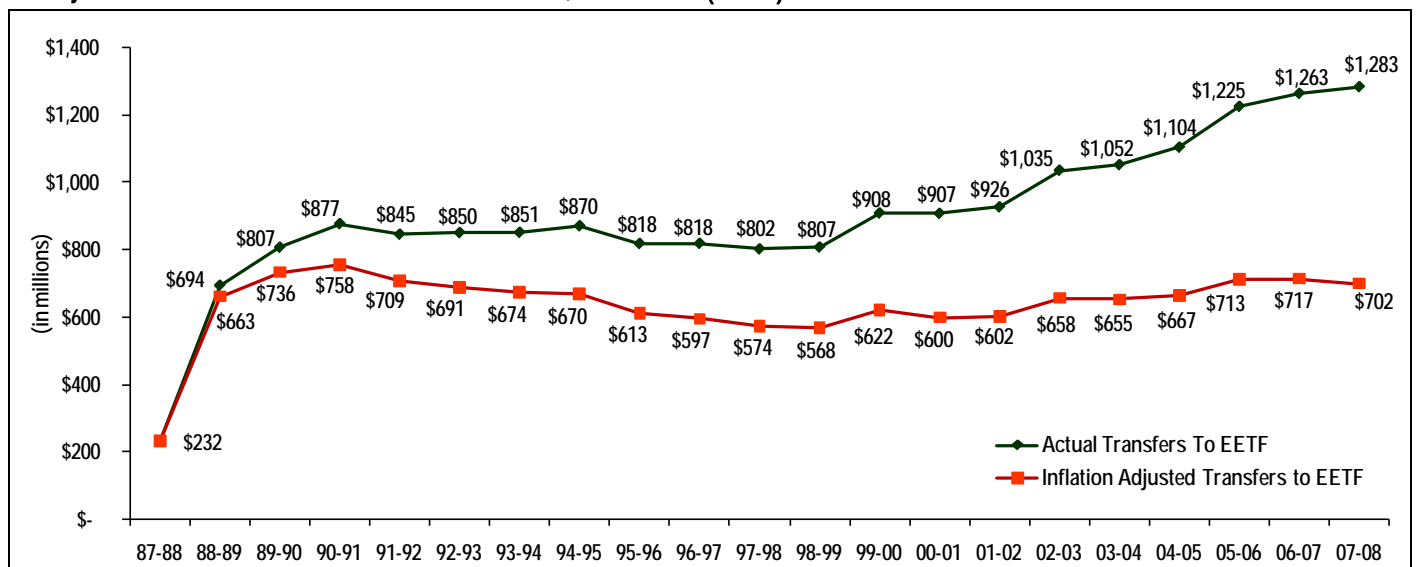
In Fiscal Year 2008-09, approximately 74%, or \$121 million, of the Lottery’s \$163 million appropriation was allocated to pay vendors for advertising and online and scratch-off games. Retailer commissions are paid directly from sales revenues and do not appear in the department’s appropriation.

Lottery Transfer Performance

In Fiscal Year 2007-08, the Lottery transferred \$1.2 billion to the Educational Enhancement Trust Fund, \$20 million more than in the prior year. As shown in Exhibit 1, transfers to education have been rising over the last seven years.

The Lottery has met its annual transfer performance goals and aims to increase annual education transfers to \$1.3 billion by Fiscal Year 2011-12; this would exceed the Revenue Estimating Conference’s projection by \$90 million. The Lottery originally set a goal of \$1.5 billion in transfers by Fiscal Year 2011-12, but has reduced this goal to reflect current economic conditions.

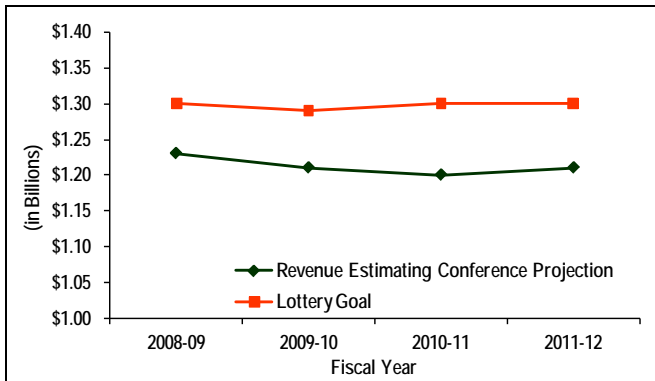
Exhibit 1
Unadjusted Transfers to Education Increased \$20 Million (1.6%) in Fiscal Year 2007-08



Source: OPPAGA analysis of Lottery data.

The department faces challenges in maintaining and growing transfers to the Educational Enhancement Trust Fund. Due to the nation’s economic downturn, consumers have less discretionary spending ability, which lowers Lottery sales. As shown in Exhibit 2, the Revenue Estimating Conference projects lower Lottery transfers to the Educational Enhancement Trust Fund through Fiscal Year 2011-12.

**Exhibit 2
The Lottery’s Goal to Increase Transfers to Education Is Above the Revenue Estimating Conference Forecast**



Source: OPPAGA analysis of Revenue Estimating Conference and Lottery Long Range Program Plan data.

Revenue Enhancement Options

The Lottery has taken several steps in the past year to maintain and increase its sales and transfers to the Educational Enhancement Trust Fund, including joining a multi-state lottery game, implementing a new scratch off game, introducing mid-day draws, and launching enhancements for three online games. In addition, the Lottery continues to use its authority to modify prize payouts to boost sales. The Lottery could further increase sales by expanding the number of retailers who sell its products. While the department has implemented several efforts to increase its retailer network, these efforts have been largely offset by losses of existing retailers. The Legislature could consider authorizing the Lottery to offer expanded gaming options such as video lottery terminals and/or a keno game, but these options could increase the negative social costs of gaming and could complicate negotiations with Indian tribe gaming.

The Lottery has implemented new games and play options to increase transfers to education. The Lottery has implemented several options presented in OPPAGA’s prior reports, such as the midday draw, a multi-state jackpot game, and multi-priced online games. The Lottery launched new games in 2008, including a \$30 scratch off game and a \$20 raffle. In May 2008, the Lottery added midday draws to the Cash 3 and Play 4 games to offer players two daily chances to play and win. While introducing new games can increase sales, the department cannot determine their impact, in part due to the countervailing impact of the national economic recession.

The department has also used its authority to offer variable prize payouts to boost sales.³ Prior to 2002, the Lottery was required by law to limit prize payouts to 50% of total sales.⁴ The Florida Legislature changed this provision to give the department more flexibility to increase prizes; larger prize payouts and increased opportunities to win tend to increase ticket sales and transfers to education. Since this change, the Lottery has generated approximately \$64 million more in transfers to the Educational Enhancement Trust Fund than it would have without this flexibility.

To stimulate online sales, in March 2008, the Lottery introduced Lotto Plus which gives players the opportunity to increase their jackpot by paying an additional \$1 or \$2 for their lotto ticket. The Lottery reports that the promotion yielded \$6.3 million in additional transfers to education.⁵

In January 2009, Florida became the 30th state to join Powerball, a multi-state jackpot game. The February 2009 Revenue Estimating Conference estimated that Powerball ticket sales will generate \$242.9 million in Fiscal Year 2008-09 and \$430.6 million in 2009-10. This would result in transfers to the Education Enhancement Trust Fund of \$48.6 million and \$85.5 million, respectively. Since January 4, 2009, Powerball ticket sales totaled

³ The variable percentages of gross revenue from the sale of online and instant lottery tickets are returned to the public in the form of prizes, designed to maximize transfers to education. Section 24.121, F.S., authorizes the use of variable prize payouts for online and instant games.

⁴ The Lottery received authority to utilize variable prize payout for instant games in 2002 and online games in 2005.

⁵ This estimate reflects net transfers to education adjusted for higher prize payouts, cannibalization, retailer incentives, and marketing efforts from March to November 2008.

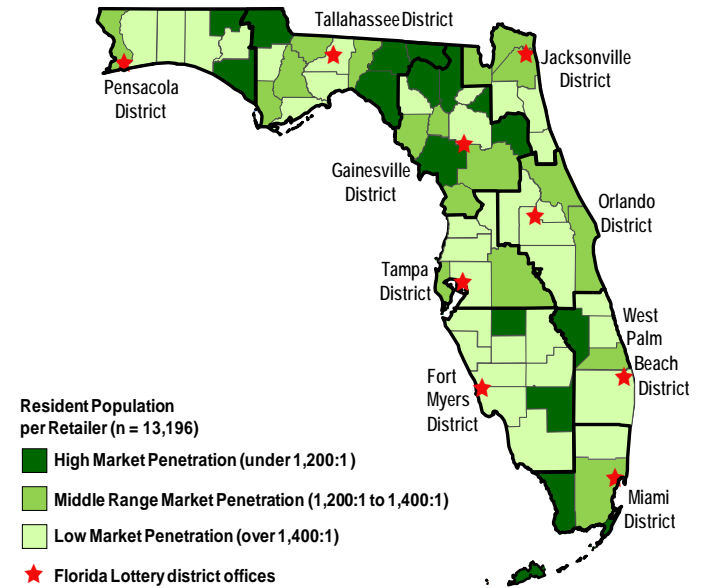
more than \$75 million, generating \$22.9 million in transfers to education.⁶ However, part of Powerball sales is diverted from other Lottery games. The Revenue Estimating Conference estimated that up to 51.9% of Powerball sales would be shifted from other games, although the Lottery reports that only 26% of initial sales were diverted from other Lottery games.

Increasing the retailer network could increase revenues but is hindered by current economic conditions. Increasing the number of retailers that sell Lottery tickets to the public has the potential to increase sales and transfers. Nationwide data on state lottery performance shows that there is a significant relationship between per capita lottery sales and the ratio of retailers to residents. In Fiscal Year 2006-07, the top 12 state lotteries ranked by per capita sales had an average of one retailer for every 1,200 residents. During this same period, the Florida Lottery averaged 1,400 residents per retailer, and ranked 11th among U.S. lotteries in per capita sales.

To meet the top-performing states' average market penetration, the Lottery would need to expand its retail network from its current 13,196 terminals to approximately 15,000 terminals. This would require legislative approval, however, as the Lottery currently has spending authority to operate a maximum of 13,500 sales terminals. OPPAGA estimates that adding 304 additional retailers, to reach the maximum currently allowed in law, in Fiscal Year 2009-10, would generate approximately \$6.2 million annually in additional transfers to the Educational Enhancement Trust Fund. Adding 1,500 retailers in order to meet the top performing states' average market penetration would generate an estimated \$30.5 million annually in transfers to education.⁷ Further, as the state's population grows and new communities are established, the number of lottery retailers should increase to keep pace with population growth.

As shown in Exhibit 3, the market penetration of Lottery retailers varies substantially across the state. In 15 counties there were fewer than 1,200 residents per retailer as of December 2008. However, 34 counties had more than 1,400 residents per retailer.

**Exhibit 3
Florida Retailer Market Penetration Varies
Across the State**



Source: OPPAGA analysis of Lottery data.

Since 2004, the Lottery increased its retail network by approximately 1,000 retailers. However, this increase has slowed in the past year. The department reported losing 2,071 retailers in Fiscal Year 2007-08 year while adding 2,252 new retailers for a net gain of 181. The department reports that reasons for losing retailers included business closures as well as terminations due to low ticket sales or other financial issues.

To increase its retailer network, over the past year the department called 2,311 prospective retailers and determined that 45% were qualified to participate in Lottery sales. In addition, the department emailed 1,963 prospective retailers and hosted four retailer recruitment seminars around the state at an average cost of \$9,624, producing 35 new retailers. The department's goal is to host three to five retailer recruitment seminars annually.

⁶ Total ticket sales reflect Powerball sales from January 4, 2009, to February 22, 2009.

⁷ These updated estimates assume that additional terminals are active, that each new terminal generates at least the Lottery's 2008 average weekly net sales per new retailer, that 20% of new sales are diverted from other retailers, and that the transfer rate is 28.4%—the current blended on-line and the scratch-off ticket transfers.

The department has recently drafted a retailer recruitment action plan that includes specific objectives, targets, and assigned responsibilities for the staff in its various business units that perform recruitment functions. In addition, the department is establishing a business development policy and writing a procedures document governing qualifying, processing, tracking and managing retailer recruitment. The department plans to analyze its various retailer recruitment efforts, including retailer recruitment seminars. In addition, the department's internal audit unit plans to examine the retailer recruitment process. The department should periodically evaluate its various retailer recruitment efforts to identify which mechanisms are most cost-effective in generating new retailers.

Lottery vending machines could enhance revenues but online machines would require legislative authorization. Since 1996, the Lottery has been authorized to sell scratch-off tickets through instant ticket vending machines, but it does not have the authority to sell online games through these machines.⁸ In 1996, when the Legislature authorized the Lottery to use vending machines to distribute scratch-off tickets, the technology did not exist to support vending machines to sell online games. This technology is now available and is an option in the Lottery's online contract. Ticket distribution using vending machines could help expand the Lottery's retailer network particularly in non-traditional markets such as restaurants, hotels, and airports.

Lottery officials report that the department has lost at least one prospective account with multiple retailer outlets because the business would only distribute Lottery products through vending machines. In July 2008, the Revenue Estimating Impact Conference concluded that instant vending machines would have a positive net impact on transfers to education of between \$4.5 million and \$16.3 million in Fiscal Year 2009-10. The Lottery proposed leasing 1,000 instant ticket vending machines in 2008, but the Legislature did not approve the request.

If the Legislature decided to authorize the department to sell online tickets using vending machines, it should consider using similar language

as in s. 24.105, *Florida Statutes*, which requires instant ticket vending machines to be under retailer supervision and within the direct line of sight to ensure that the machine is monitored and only operated by persons at least 18 years old.

Video lottery terminals and keno games have the potential to increase revenues but could raise the social costs of gambling and affect future negotiations with the Seminole Tribe. Other states offer some games that are not offered by the Florida Lottery. These games have the potential to attract new players and substantially increase transfers to education. For example, we estimate introducing video lottery terminals could increase transfers to education between \$529 million and \$852 million in Fiscal Year 2009-10.⁹ In addition, a keno-type game, i.e., a "quick draw" game, could generate between \$37 million and \$340 million in Fiscal Year 2009-10.¹⁰

Implementing such games, however, would represent an expansion in gambling and produce associated negative social consequences. Video lottery terminals and keno are considered to be more addictive than traditional lottery games and could contribute to problem and pathological gambling rates and increase law enforcement costs to combat crime typically associated with gambling. The National Gambling Impact Study Commission estimated that the annual average costs of job loss, unemployment benefits, welfare benefits, poor physical and mental health, and problem or pathological gambling treatment to society is approximately \$1,195 per pathological gambler per year and approximately \$715 per problem gambler per year. The magnitude of such negative effects if the Lottery was authorized to provide video lottery

⁹ OPPAGA worked with the Office of Economic and Demographic Research to develop the methodology to calculate these estimates. The revenue estimates for keno are based on per capita performance while revenue estimates for video lottery terminals are based on net income per machine. The keno range is based on high and low state per capita sales after excluding the outlier states from the upper and lower quartiles. The video lottery terminal range is based on the Slot Revenue Estimating Conference estimates for the Broward County pari-mutuel facility's lowest net income per machine to the highest net income per machine. For keno, the current on-line transfer rate to the Educational Enhancement Trust Fund of 39.93% was used and 50% for video lottery terminal estimates.

¹⁰ Keno is an on-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers to match their choices to those drawn by a central computer. Keno is similar in principle to other on-line games, but it is played more frequently (normally every five minutes) and in social settings such as a bar or restaurant. Video lottery terminals are player activated and can be programmed to play casino-style games such as poker, blackjack, keno, and/or bingo; or simulate mechanical slot machines or roulette wheels.

⁸ Section 4, Ch. 96-341, *Laws of Florida*.

terminals and keno games cannot be reliably estimated given Florida’s currently authorized gaming options such as Indian casinos and slot machines in Broward County pari-mutuel facilities.

Decisions to authorize video lottery terminals would need to take into account revenue sharing agreements that may be made between the State of Florida and Indian tribes.¹¹ In November 2007, the Governor entered an agreement with the Seminole tribe providing partial but substantial exclusivity to the tribe to operate casino type games such as slots, high-stakes poker, and blackjack in exchange for a share of the revenue with the state. Authorizing video lottery terminals could violate that compact. However, in July 2008, the Florida Supreme Court declared the compact null and void, and the Legislature is currently considering what action to take regarding the compact.

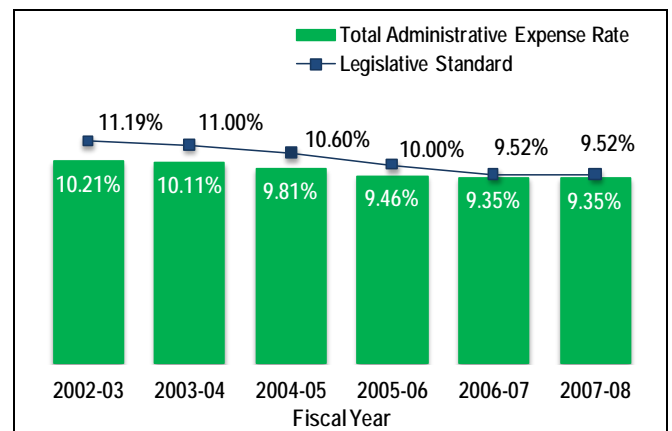
Operational Efficiency Options

The Lottery continues to improve on a key indicator of its operational efficiency, expenses as a percentage of sales, but its overall administration costs have increased. As recommended by OPPAGA, the Lottery altered its scratch-off vendor contract to reduce vendor commissions; however, it has not modified its retailer commission rates. The Lottery has negotiated lower rates for its headquarters lease but still leases excess office space and has not successfully located a tenant for a sublease. The Lottery continues to use a marketing calendar to guide its efforts but has no evaluation component to assess the return on its advertising investments. Finally, the department has not competitively secured general advertising services.

¹¹ In 1987, the U.S. Supreme Court held that tribal governments have the authority to establish gaming operations independent of the state regulation provided that the state permits some form of gaming. To provide the statutory basis for the operation and regulation of gaming by Native American tribes, Congress passed the Indian Gaming Regulator Act in 1988. The act permits states to determine the scope and extent of tribal gaming through tribal-state compacts for Class III gaming and gives the tribes regulator authority over Class I and II gaming. Class I games are under the exclusive jurisdiction of tribes and include social games and traditional and ceremonial games. Class II excludes house-banked card games but includes bingo, pull tabs, and games similar to bingo, plus non-banking card games (unless prohibited by state law). Class III includes all other types of gambling, including house-banked card games, slot machines, pari-mutuel racing, jai-alai, and electronic games of chance.

The Lottery’s administrative expense rate has declined over time, but commission payments have increased. Over the past five years, the department has reduced its expenses as a percentage of sales revenue from 10.21% to 9.35%.¹² As shown in Exhibit 4, the Lottery has consistently kept its administrative expense rate below its legislative performance standard. Compared to other state lotteries, the Lottery had the fifth lowest administrative expense rate in Fiscal Year 2006-07.¹³

Exhibit 4
The Lottery’s Administrative Expense Rate Has Declined Over Time



Source: OPPAGA analysis of Lottery performance information submitted to the Legislature.

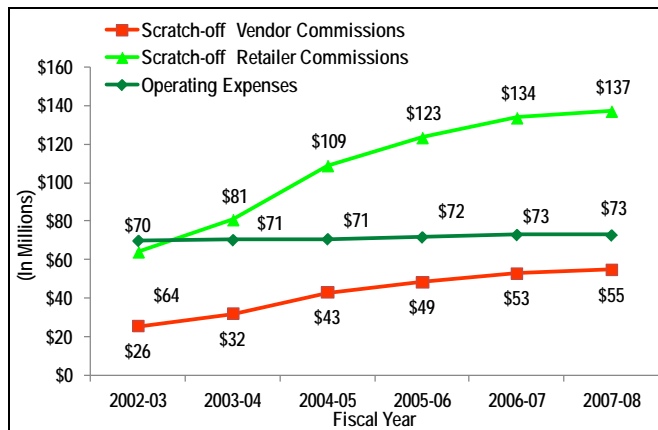
While the Lottery’s administrative expense rate has declined, its overall administrative costs have increased. Between Fiscal Years 2002-03 and 2007-08, total administrative expenses increased from \$293 million to \$390 million. The largest component of the department’s administrative costs are retailer, online, and scratch-off vendor commissions, which comprised 81% of the Lottery’s total administrative expenses in Fiscal Year 2007-08. As shown in Exhibit 5, retailer and scratch-off vendor commissions account for virtually all of the increase in the Lottery’s administrative costs, as its internal operating expenses remained relatively flat.¹⁴

¹² Expenses include all costs incurred in the operation and administration of the Lottery including advertising fees and vendor and retailer commissions.

¹³ Florida Lottery’s ranking is based on the latest fiscal year data available from *La Fleur’s 2008 World Lottery Almanac*. The 2009 edition will be published in April 2009.

¹⁴ Operating expenses include in-house functions such as

**Exhibit 5
Commissions Account for Most Lottery
Administrative Costs**



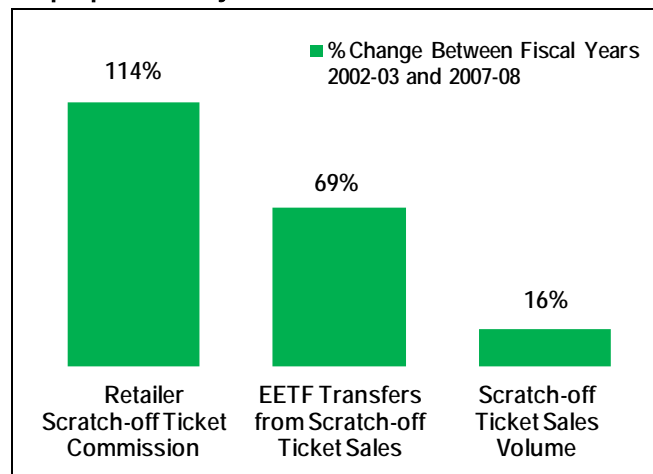
Source: OPPAGA analysis of Lottery financial statements.

The Lottery changed its scratch-off ticket vendor payment structure but continues to pay retailers disproportionate to ticket volume sales and transfers to education. In October 2008, as recommended by OPPAGA, the Lottery entered a six-year contract with its scratch-off games vendor and negotiated new vendor payment terms that provide the vendor with incentives to help maximize the transfers to education. This will save the state an estimated \$153 million, or \$25.5 million annually, over the life of the contract.

The Lottery has not made a similar change to its retailer agreements. To increase sales and transfers to education, the Lottery began offering higher value games such as \$20 Raffle and \$20 and \$30 scratch-off games. However, the Lottery did not change its method for paying commissions to retailers to reflect these changes in ticket pricing. Retailers are currently paid a 5% commission for each ticket they sell, equating to five cents for each \$1 ticket sold, \$1 for each \$20 ticket, and \$1.50 for each \$30 ticket they sell, although they do not incur additional costs for selling the higher priced tickets.¹⁵ Overall scratch-off ticket sales, driven by the higher priced games, have increased substantially over the last five fiscal years.

As shown in Exhibit 6, retailer commissions have increased substantially and disproportionately to the volume of scratch-off tickets sold and are likely to further increase with higher priced ticket sales. Retailer commissions have increased 114% over the last five years from \$64 million to \$137 million, while the number of tickets sold has increased by 16% and transfers to education have increased 69% during the same period. The Lottery could consider modifying the retailer payment structure, as it did with its scratch-off vendor contract, to reward retailers for performance that reflects the volume of tickets sold and their contribution to the Lottery's ultimate goal of education funding. This step would continue to provide reasonable incentives to retailers while reducing the department's administrative costs. The Lottery reports that it will explore changes to its current retailer commission structure by conducting surveys and focus groups in the upcoming year, but it has no formal plan or deadline to address the issue.

**Exhibit 6
Scratch-Off Ticket Commissions Have Increased
Disproportionately to the Volume of Tickets Sold**



Source: OPPAGA analysis of Lottery financial statements and ticket sales data.

While the department has taken steps to reduce leased space costs, it continues to lease excess space at its headquarters location. Since 2002, OPPAGA has recommended that the Lottery reduce its excess office space. The Lottery leases 157,653 square feet of space at its headquarters, which includes 127,582 square feet of office space (located mostly on the top two floors of a four-story

information services, marketing, public affairs, finance and budget, games administration, product development, security, field support, and contracted services such as advertising.

¹⁵ The Lottery recently stopped producing new \$30 scratch-off games, but may reintroduce the game in the future.

building) and 30,071 square feet of air-conditioned warehouse space (located on the bottom two floors).

The department had the opportunity to explore alternative lease options when its lease expired in June 2008. As recommended by OPPAGA, the Lottery contracted with a consultant group to conduct a cost-benefit analysis and buy versus lease business case to reduce its leased office space. The analysis also assessed the options of moving to state-owned property, moving to a new leased building, and negotiating with the current landlord for a reduction in leasing costs and/or the amount of space leased.

In accordance with the contracted study recommendations, in July 2008, the Lottery negotiated with the current landlord to execute both of its 5-year renewal options at once for a total 10-year lease. The department negotiated a reduced rate per square foot resulting in a net cost avoidance of \$56,000 annually over the life of the 10-year lease. The renewed lease includes \$2.34 million in tenant improvement funds. In addition, the landlord agreed to provide janitorial and landscaping services, which will result in an estimated cost avoidance of \$163,000 per year. Under the renewed lease, the Lottery is paying a combined office and warehouse rate of \$16.25 per square foot per year for a total of \$2.56 million in Fiscal Year 2008-09.¹⁶

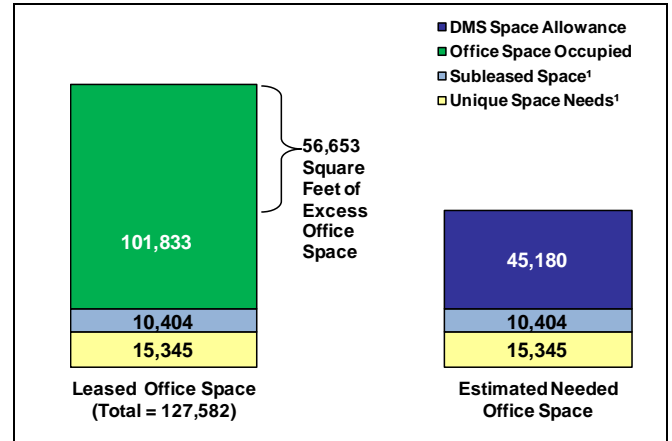
Nonetheless, the Lottery will continue to lease more than twice the amount of office space recommended by the Department of Management Services per full-time equivalent employee at an excess annual cost of over \$920,000. Since the late 1990s the Lottery has reduced its need for office and warehouse space through staff reductions and outsourcing functions such as telemarketing and scratch-off ticket distribution. However, the Lottery has not commensurately lowered its operational costs by reducing the amount of space it leases.

The Lottery occupies about 101,833 square feet of leased office space for its 251 employees at its headquarters, approximately 406 square feet per employee. The Department of Management Services has established a recommended standard of 180 square feet per employee, which equates to 45,180 square feet of office space for Lottery staff.

¹⁶ The Lottery currently subleases office and warehouse space to its vendors, reducing its lease payments by \$230,883 in Fiscal Year 2007-08 (\$169,065 for office space and \$61,818 for warehouse space).

Therefore, as shown in Exhibit 7, the department leases 56,653 square feet of excess office space (this comparison considers the Lottery’s unique and special needs and space already subleased).¹⁷

**Exhibit 7
The Lottery Leases 56,653 Square Feet of Office Space in Excess of Its Needs**



¹ The Lottery’s need for leased office space includes office space already subleased (10,404 square feet) and for unique and special needs (15,345 square feet).

Source: OPPAGA analysis of Lottery data.

In its recent report to the Legislature, the Lottery reported that it has not been able to find a suitable tenant to sublease its excess leased office space. However, it is planning to relocate its draw studio operations to the headquarters facility, which will absorb 3,672 square feet, or 6%, of the 56,653 square feet of excess office space.¹⁸

The department has previously proposed including a provision in its next general market advertising procurement to reserve the right to mandate that the successful vendor sublease office space at the Lottery’s headquarters location. Since the Lottery’s advertising contract has expired, it should include this option when it enters the procurement process.

¹⁷ Adjustments include the Lottery’s subleased office space for its on-line and scratch-off ticket vendors (10,404 square feet) and its unique office space needs (15,345 square feet) including extra large meeting rooms, graphics studio, gaming system testing area, winner’s lounge/payout room, central alarm station, dedicated computer/technology training room, forensics/ticket testing and evidence areas, and video production space.

¹⁸ The Lottery’s goal is to relocate the draw studio and complete construction by June 2009.

The Lottery needs to further capitalize on its marketing data to inform future marketing decisions. While the Lottery has not developed a formal marketing plan, it has used a marketing calendar to plan its activities. The calendar serves as a strategic planning tool for all lottery games with a year-long perspective and acts as a flexible management tool that outlines each of the Lottery's products along a timeline with associated assigned responsibilities and key benchmarks. The marketing calendar meets some functions of a formal marketing plan including outlining a media strategy, sales strategies, associated budgets, and assigned unit responsibilities. The Lottery's marketing objectives are to sell out scratch-off games and maximize online game sales. Using the marketing calendar allows the department to alter specific games and/or marketing strategies in response to changing market conditions. The department reports that information from sales data, product development, and advertising is used to assess whether specific changes are needed in the marketing calendar. However, while the calendar provides specific tactics to facilitate launching advertising campaigns, the process lacks an integrated accountability process to inform future marketing decisions.

As we recommended, the Lottery has taken steps to strengthen its marketing evaluation process. To address this issue, the Lottery contracted with an independent group in April 2008, to compare its advertising expenditures to other lotteries and industries, assess the erosion of its advertising expenditures due to inflation, and conduct a feasibility study to determine advertising return-on-investment. The study, released in June 2008, found that the Lottery's ratio of advertising expenses to sales were relatively low when compared to other state lotteries and industries and that TV media spending has not kept up with media costs. Prior to conducting the study, the contractor determined that an evaluation of advertising return-on-investment was feasible and would cost up to \$200,000. Lottery administrators did not proceed with the advertising return-on-investment evaluation due to the vendor's proposed cost.

Currently, the Lottery analyzes consumer purchasing trends through surveys and compares sales before and after a marketing campaign to evaluate its advertising efforts. While Lottery

administrators evaluate the department's advertising efforts by reviewing monthly player tracking surveys and sales data at weekly sales meetings, their evaluation does not include data categorized by game or media outlet such as TV or radio. To better target its limited advertising dollars and maximize advertising investments, we recommend that the department link its sales and transfer data, advertising expenditures, and player profile data by game and media outlet type. To further improve future marketing decisions, the Lottery should also consider developing a long-term evaluation process for its marketing program. This evaluation could include experimental and control groups to determine specific return on investment by advertising campaign, which the department has done in the past.

The Lottery has not finalized a competitive process to secure advertising services. Advertising is one of the department's core contracted functions and is critical to the success of Lottery games and, ultimately, maximizing education transfers. To improve the efficiency of Lottery operations, the 2008 Appropriations Act included proviso language, effective July 1, 2008, requiring the department to replace its current advertising contracts through a competitive solicitation pursuant to statute to ensure that the advertising contract provides the best value to the state.^{19, 20} The proviso language further stated that the department was prohibited from extending or renewing its current advertising contract.²¹

Prior to this language taking effect on July 1, 2008, the Lottery renewed its advertising contract with Cooper DDB when it expired on June 30, 2008; the day prior to the proviso language taking effect. Under this renewal agreement, the Lottery has continued to receive services from Cooper DDB without entering into contract solicitation, using a month-to-month arrangement in which payments

¹⁹ The 2008 Appropriations Act placed two limits on the Lottery's advertising expenditures. First, the law states the Lottery is to spend no more than \$3,486,945 for any advertising agency or consultant for strategic planning, marketing communications, public relations, account management and services, media planning, media negotiation and placement, and sales promotions. Second, the Lottery will not spend in excess of \$200,000 for the development, publication and distribution of any report by the department for informing the public about the significance of Lottery funding to the state's overall system of public education.

²⁰ Section 287.057, *F.S.*

²¹ Section 2781, Ch. 2008-152, *Laws of Florida*.

are calculated on a specified cost-per-hour, per-project basis. This renewal agreement had a flexible termination date which was projected to be on or about December 31, 2008, or upon completion of competitive solicitations. The department subsequently did not begin competitive solicitations by December 31, 2008, and continues to operate under the month-to-month renewal terms.

The department’s advertising costs have increased under this arrangement. Under the original contract terms (Fiscal Year 2007-08), the department paid Cooper DDB a total of \$3.5 million annually, an average of \$298,000 per month.²² Under the renewal contract terms, the department paid the vendor approximately \$2.1 million, or an average of \$345,898 per month for the six-month period July 1 through December 31, 2008. The department reports that monthly payments have increased due to new Powerball advertising and promotions.²³

On February 6, 2009, the Lottery issued a Request for Letters of Interest to solicit vendors to provide artistic and creative advertising services through an informal competitive process. The Lottery expects to secure services and have an advertising contract by May 2009. The department reports that launching the Powerball game delayed this procurement process. Consistent with legislative intent, the department should take immediate steps to finalize this competitive process and select a vendor that, for a reasonable cost, will help ensure that the Lottery maximizes sales and meets its targets for education funding transfers.

Recommendations —————

To continue to increase Lottery sales and transfers to education, we recommend that the department continue to expand its retailer network to increase sales distribution and revenues and evaluate its retailer recruitment efforts to determine which mechanisms are most cost effective and efficient at attracting new retailers.

²² The contract term with Cooper DDB was July 1, 2002, to June 30, 2008. The annual cost in FY 2007-08 was \$3,572,578.

²³ The Lottery spent approximately \$2 million of its \$5.2 million annual media and promotion budget converting 143 statewide Lotto jackpot billboards to Powerball jackpot billboards.

We also recommend that the Lottery submit a proposal to the Legislature relating to use of vending machines for online ticket sales. If the Legislature chooses to authorize the Lottery to use vending machines to sell online games, it could consider mandating that all Lottery product vending machines be under direct retailer supervision and within direct line of sight to ensure that minors cannot use the machines.

We also recommend that the department take immediate steps to competitively secure advertising services as required by appropriations proviso. We further recommend that the Lottery establish alternative retailer payment terms that reduce commissions for selling higher-value scratch off tickets while providing reasonable sales incentives. This could produce substantial cost savings to the state. The Lottery also should continue to work with the Department of Management Services to sublease its excess headquarters office space. As part of this effort, the department should reserve the right to mandate that the successful advertising vendor sublease office space at the Lottery’s headquarters location.

Finally, to better target its limited advertising dollars and maximize advertising investments, we recommend that the department break sales, advertising, and player profile data down by game and media outlet (e.g., internet, print, radio, TV) to provide more precise evaluative information for use in future advertising decision making. To further improve future marketing decisions, the Lottery should also consider developing a long-term evaluation process for its marketing program. This evaluation could include experimental and control groups to determine specific return on investment by advertising campaign, which the department has done in the past.

Agency Response —————

In accordance with the provisions of s. 11.51(5), *Florida Statutes*, a draft of our report was submitted to the Secretary of the Department of the Lottery for review and response. The Secretary’s written response to this report is in Appendix A.

Appendix A

CHARLIE CRIST
Governor



LEO DIBENIGNO
Secretary

FLORIDA LOTTERY

March 6, 2009

Gary R. VanLandingham, Ph.D.
Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Dr. VanLandingham:

Thank you for the opportunity to respond to your office's report entitled, "Lottery Profits Are Slowing with Economic Downturn; Advertising Services and Retailer Commissions Need to Be Addressed." Our response is organized around your recommendations.

Retailer Network Expansion

To continue to expand Lottery sales and transfers to education, we recommend that the department continue to expand its retailer network to increase sales distribution and revenues and evaluate its retailer recruitment efforts to determine which mechanisms are most cost effective and efficient at attracting new retailers.

The Lottery concurs with both parts of this recommendation. We have been working to expand our retailer base since the conversion to a new, on-line gaming system in January 2005, and we will continue to strive for retailer densities on par with lotteries having the best per capita sales.

Within the past year, two key factors have slowed our progress toward this goal. First, the poor economy has forced a number of smaller, independent businesses to withdraw as lottery retailers. As noted in the report, even though more than 2,000 businesses have joined the Florida Lottery retailer network, a nearly equal number have dropped out. Second, the lack of funding authorization for instant ticket vending machines (ITVMs) has made it very difficult to persuade the largest corporate chains to sign on as lottery retailers. Corporate chains, such as CVS Pharmacy and Wal-mart, have been unwilling to sell lottery tickets without the vending machines that could help them manage their inventories and labor costs. ITVMs—or, even more so, machines that sell both on-line and instant games—would greatly increase the chances of landing corporate, multi-store accounts.



250 MARRIOTT DRIVE • TALLAHASSEE, FLORIDA • 32301 • (850) 487-7777
www.flalottery.com

Dr. Gary VanLandingham
OPPAGA Response
March 6, 2009
Page 2 of 5

As the report states, the Lottery already has begun studies of the effectiveness of its various recruitment efforts. Perhaps the furthest along is the study of the retailer recruitment seminars where all cost information has been collected and work is underway regarding the revenues generated by newly recruited businesses. Recommendations from this study will be acted upon later this spring; other analyses will follow.

Submission of a Vending Machines Proposal

We also recommend that the Lottery submit a proposal to the Legislature relating to use of vending machines for instant and on-line ticket sales. If the Legislature chooses to authorize this action, it could consider mandating that all instant lottery machines be under direct retailer supervision and within direct line of sight to ensure that minors cannot use the machines.

Instant Ticket Vending Machines (ITVMs) are currently authorized in Florida Statutes. We concur that legislative approval of ITVM budget authority would yield higher sales and Educational Enhancement Trust Fund profits for Florida. As noted in the OPPAGA report, a Revenue Impact Conference reached the same conclusion. A successful pilot test of the newer generation of ITVMs in 2007, written commitments from existing Florida businesses to place over 500 ITVMs a year ago, and the corporate retailer recruiting advantage noted previously further support the decision to use these types of machines in Florida Lottery retailer locations. Over time, the Lottery believes 2,000 ITVMs could be placed in existing and newly established retailers such as the large merchandise chains mentioned above.

Advertising Services

We also recommend that the department take immediate steps to competitively secure advertising services as required by appropriations proviso.

In accordance with the provision of the Fiscal Year 2008-2009 General Appropriations Act (Section 6, Specific Appropriation 2781), the Florida Lottery has already initiated a competitive procurement for advertising services. Execution of a contract is expected to take place by May 2009.

Retailer Payment Terms

We further recommend that the Lottery establish alternative retailer payment terms that reduce commissions for selling higher-value scratch off tickets while providing reasonable sales incentives.

Dr. Gary VanLandingham
OPPAGA Response
March 6, 2009
Page 3 of 5

During the current year, the Lottery will analyze and develop recommendations regarding alternative payment terms for lottery retailers. However, the goal of this project will be to increase transfers to the Education Enhancement Trust Fund (EETF) rather than simply to reduce retailer costs. It is our strong belief that an exclusive focus on cost reduction could damage our relationship with existing retailers, run counter to our mission of increasing transfers to educational enhancement funding and thwart our efforts to expand our retailer base. Florida Lottery retailer compensation rates are already lower than those of other lotteries, ranking in the bottom 30 percent of U.S. lotteries. We also face stiff competition for the consumer's discretionary spending from other product lines (beer, movies, snacks, magazines, etc.) whose companies often pay higher sales commission rates and provide additional payments for display and shelf space. The fact of the matter is retailers voluntarily choose to carry Lottery tickets and if they believe that our compensation model isn't conducive to their business needs, they may simply stop offering Lottery tickets. This would have an immediate, negative impact on EETF funding. If OPPAGA, in preparing this report, uncovered data that shows of another lottery utilizing their recommendation, the Florida Lottery would appreciate reviewing it as part of our research.

The Lottery will analyze and explore ideas for a retailer compensation framework which will have as its goal, increasing EETF contributions. This will involve examination of the payment structures of other lotteries and other consumer product companies, surveys of our retailers and possibly the use of testing compensation plans in some areas.

Excess Headquarters Office Space

The Lottery also should continue to work with the Department of Management Services to sublease its excess headquarters office space. As part of this effort, the department should reserve the right to mandate that the successful advertising vendor sublease office space at the Lottery headquarters location.

The Florida Lottery concurs with OPPAGA to continue working with DMS to identify suitable tenants to sublease its excess headquarters office space. The Florida Lottery already subleases headquarters office space to two of its major vendors and will consider, as OPPAGA recommends, the headquarters co-location of its advertising agency. However, any co-location must ultimately be in the Lottery's best interests (business, security, and financial), as determined during the negotiation phase of the advertising competitive procurement.

Dr. Gary VanLandingham
OPPAGA Response
March 6, 2009
Page 4 of 5

Advertising

To better target its limited advertising dollars and maximize advertising investment, we recommend that the department break sales, advertising, and player profile data down by game and media outlet (e.g., internet, print, radio, TV) to provide more precise evaluation information for use in future advertising decision making.

We concur with OPPAGA's recommendation that sales and advertising expenditures should be broken down into much needed granular information. That is one of the reasons the Department has since 2005, repeatedly requested the authority to implement a Business Accounting solution. To this date, the Department's requests have been denied for various reasons, mostly financial. Despite the lack of this needed business tool, for Fiscal Year 2008-2009, the department has already implemented an alternative approach that will allow the break down of advertising expenses by both game and media type to support future decisions. While this approach is not the desired long-term solution, we believe it to be an acceptable approach for the short-term, particularly when the information is used in conjunction with the Lottery's detailed sales and player information.

Long-Term Marketing Evaluation Process

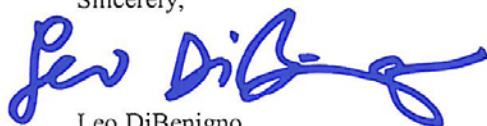
To further improve future marketing decisions, the Lottery should also consider developing a long-term evaluation process for its marketing program. This evaluation could include experimental and control groups to determine specific return on investment by advertising campaign, which the department has done in the past.

The Lottery continually explores ways to expand awareness of all products, be it with a measured media buy, leveraged buys, and sponsorships to a broad audience. The options to communicate have gone beyond traditional spot buys with television and radio channels. New forms of advertising are continually introduced and staff looks for ways to determine their value in our overall marketing strategy. The Lottery will continue to improve with our private sector marketing partners' new measurement methods that provide greater accuracy and reliability in order to maximize our return of investment.

Dr. Gary VanLandingham
OPPAGA Response
March 6, 2009
Page 5 of 5

In closing, the Florida Lottery always welcomes constructive suggestions for ways to improve our performance and productivity. Thank you for the time and attention your staff and you have devoted to this year's review.

Sincerely,



Leo DiBenigno
Secretary

LD/ms

cc: Dennis Harmon, Deputy Secretary
Andy Mompeller, Inspector General
Marcy Jackson, Chief Financial Officer
Pat Koop, Chief Marketing Officer
Terry Perkins, Chief Administrative Officer
Eli Nortelus, Legislative Affairs Director

The Florida Legislature

Office of Program Policy Analysis and Government Accountability



OPPAGA provides performance and accountability information about Florida government in several ways.

- [OPPAGA reviews](#) deliver program evaluation, policy analysis, and Sunset reviews of state programs to assist the Legislature in overseeing government operations, developing policy choices, and making Florida government better, faster, and cheaper.
- [OPPAGA PolicyCasts](#), short narrated slide presentations, provide bottom-line briefings of findings and recommendations for select reports.
- [Florida Government Accountability Report \(FGAR\)](#), an Internet encyclopedia, www.oppaga.state.fl.us/government, provides descriptive, evaluative, and performance information on more than 200 Florida state government programs.
- [Florida Monitor Weekly](#), an electronic newsletter, delivers brief announcements of research reports, conferences, and other resources of interest for Florida's policy research and program evaluation community.
- Visit OPPAGA's website, the Florida Monitor, at www.oppaga.state.fl.us

OPPAGA supports the Florida Legislature by providing evaluative research and objective analyses to promote government accountability and the efficient and effective use of public resources. This project was conducted in accordance with applicable evaluation standards. Copies of this report in print or alternate accessible format may be obtained by telephone (850/488-0021), by FAX (850/487-3804), in person, or by mail (OPPAGA Report Production, Claude Pepper Building, Room 312, 111 W. Madison St., Tallahassee, FL 32399-1475). Cover photo by Mark Foley.

Project supervised by Jane Fletcher (850/487-9255)
Project conducted by Sabrina Hartley (850/487-9232) and Farah Khan
Gary R. VanLandingham, Ph.D., OPPAGA Director