



March 2011

Report No. 11-12

Lottery Profits Decline; Options Available to Enhance Transfers to Education

at a glance

Lottery transfers to the Educational Enhancement Trust Fund declined by \$41 million in Fiscal Year 2009-10, due to a variety of economic and demographic factors, and are projected to further decline by \$106 million in 2010-11. During 2010, the Lottery took several steps to maintain and stimulate sales including launching a new game and expanding its use of instant ticket vending machines.

To increase transfers to education, the Lottery should continue expanding its retailer network. In addition, it should evaluate the benefits of adding a fast keno game and continue to assess the option of joining another multi-state game. The Legislature could consider authorizing full-service vending machines, Internet sales, and video lottery terminals. However, these options represent expanded gambling, and video lottery terminals would violate the revenue sharing agreement of the gaming compact between the State of Florida and the Seminole Tribe of Florida.

The Lottery's operating expense rate continues to decline, making it among the most efficient U.S. lotteries. It could realize additional efficiencies and increase transfers to education by ensuring that its retailer compensation structure represents the best value for the state.

Scope

As directed by the Legislature, OPPAGA examined the Department of the Lottery and assessed options to enhance its earning capability and improve its efficiency.¹

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 sells both on-line and scratch-off games. On-line games allow players to pick from a range of numbers on a play slip. On-line game tickets are printed by terminals that are connected to the Lottery's central computer system for a drawing at a later date. Scratch-off games are tickets with latex covering that players scratch off to determine whether they have won.

The Lottery is headquartered in Tallahassee with nine district offices that serve the dual role of providing field support services to

¹ [Section 24.123, F.S.](#), requires an annual financial audit of the Lottery, which is to include recommendations to enhance the Lottery's earning capability and efficiency. The Joint Legislative Auditing Committee directed OPPAGA to assess Lottery efficiency and the Auditor General to conduct the financial audit.

retailers and acting as prize redemption and sales centers.² The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2010-11, the Legislature appropriated \$135 million from Lottery sales revenue and authorized 437 positions for Lottery operations. Retailer commissions are paid directly from sales revenues and do not appear in the department's appropriation. In Fiscal Year 2009-10, retailer commissions were \$216 million.³

Since its inception, the Lottery's core functions to produce, advertise, and sell tickets have been outsourced. In Fiscal Year 2010-11, approximately 70%, or \$95 million, of the Lottery's \$135 million appropriation was allocated to pay vendors to produce and advertise on-line and scratch-off games. Vendor contracts include those listed below.

- In October 2010, the Lottery entered a four-year renewal contract by executing two, two-year renewal options with GTECH, its on-line gaming system vendor, to provide computer systems, retailer terminals, software, telecommunications, and technical support services.
- In September 2010, the Lottery entered a two-year renewal contract with Machado Garcia-Serra Advertising, Inc., for Hispanic market advertising.
- In August 2009, the Lottery entered a three-year contract with St. John & Partners Advertising and Public Relations Inc., for

general market advertising. In October 2010, the Lottery exercised its first one-year renewal option to take effect August 2012.

- In September 2008, the Lottery entered a six-year contract with Scientific Games to print, market, and distribute scratch-off game tickets.

Performance

In Fiscal Year 2009-10, the Lottery transferred \$1.247 billion to the Educational Enhancement Trust Fund, \$41 million less than the prior year. The Lottery exceeded its legislatively approved transfer performance standard of \$1.206 billion for 2009-10 fiscal year and has reported a primary objective of transferring at least \$1 billion annually to the Educational Enhancement Trust Fund.

As shown in Exhibit 1, Lottery transfers to education have declined, due to a variety of economic and demographic factors including the depressed economy that limits consumers' discretionary spending on lottery products and reduced population growth. (See Appendix A for the Lottery's market share of disposable personal income.) The February 2011 Revenue Estimating Conference projected that Lottery transfers to education will further decline by \$106 million in Fiscal Year 2010-11 and may increase in 2011-12.

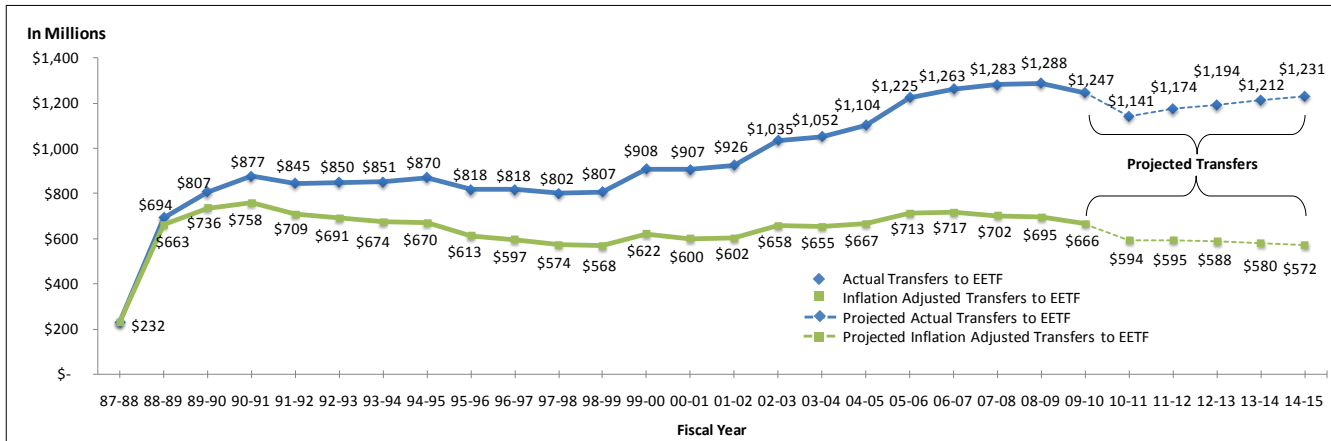
The effect of inflation also lowers the purchasing value of the Lottery's transfers to education. Inflation adjusted transfers to education have remained relatively flat over the past 20 years but have declined annually since Fiscal Year 2006-07. Inflation will continue to erode the value of the Lottery's education transfers unless the Lottery increases the dollar value of the transfers to at least meet the rate of inflation.

² Lottery retailers can pay prizes up to \$599. District offices can pay up to \$250,000 for Florida Lottery prizes and up to \$1 million for Powerball. Prizes exceeding these amounts must be collected at Lottery headquarters in Tallahassee.

³ To sell its products, the Lottery contracts with a wide range of retailers across the state such as supermarkets, convenience stores, gas stations, and newsstands. Retailers receive commissions for selling Lottery products at a rate of 5% of the ticket price in addition to 1% of the prize value for redeeming winning tickets. Retailers can also receive bonuses for selling select winning tickets and performance incentive payments.

Exhibit 1

Unadjusted Transfers to the Educational Enhancement Trust Fund (EETF) Declined \$41 Million (3%) in Fiscal Year 2009-10 and Are Projected to Decrease \$106 Million in Fiscal Year 2010-11 before Increasing by \$33 Million in Fiscal Year 2011-12¹



¹ Projected transfers from the February 2011 Revenue Estimating Conference were adjusted for inflation using the previous five-year average rate of 1.4%.

Source: OPPAGA analysis of Lottery financial data, Revenue Estimating Conference, February 8, 2011, and U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index.

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. While generally successful, these efforts have not been enough to avoid a decline in Lottery transfers to education. To increase sales and transfers, the Lottery could implement additional games or expand product distribution by adopting new ways of selling lottery tickets and continuing to expand its retailer network. Appendix B provides a list of new game options and Appendix C provides a list of product distribution options.

The estimated values of the revenue enhancements outlined below are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one game to another. Estimates of annual revenue assume full implementation by July 1, 2011; however, some options would require additional time to implement, such as installing video lottery terminals or electronic instant ticket vending machines around the state.

The department made several changes in the last year in an effort to encourage sales

The Lottery has continued to enhance its product mix and product distribution to stimulate sales. In October 2010, the Lottery launched Lucky Lines, a new multi-priced on-line instant-win game.⁴ The February 2011 Revenue Estimating Conference estimated Lucky Lines sales of \$50 million in Fiscal Year 2010-11 and \$33 million in 2011-12. These sales figures translate into approximately \$16 million in transfers to education in Fiscal Year 2010-11 and \$11 million in 2011-12, after accounting for shifts in sales from other Lottery products.

In August 2010, the Florida Lottery became the first U.S. lottery to launch a 1-Off play feature to its daily Cash 3 game. This allows players to miss one or more of the three digits in their

⁴ Lucky Lines tickets cost \$1, \$2, \$3, or \$5, with top prizes ranging from \$400,000 for a \$1 ticket to \$3 million for a \$5 ticket. Players select how much to spend on a ticket and seven numbers from 1 to 49, or opt for a Quick Pick. The player is then able to view a ticket containing their seven numbers and a game board. Similar to bingo, players must match their numbers in a horizontal, vertical, or diagonal line to win. Or, players can double-their-money if all seven of their numbers are scattered on the game board without touching.

Cash 3 number by one and still win. The Lottery's preliminary estimate assumed a 3.5% net Cash 3 sales increase, which would generate about \$14 million in sales and about \$6 million in additional transfers to education in Fiscal Year 2010-11.

The 2010 Legislature provided budget authority, allowing the Lottery to install 500 more instant ticket vending machines. The Lottery had previously installed 1,000 vending machines in 2009, mostly in supermarket retailers.⁵ Between October and December 2010, the Lottery installed these additional machines across the state at supermarket retailers such as Publix as well as other types of retailer locations such as B.J.'s Wholesale, K-Mart, Pantry, Racetrac, and 7-Eleven.⁶

The first 1,000 instant ticket vending machines, which were installed at the Lottery's highest selling retailers around the state, appear to have exceeded initial sales estimates. Scratch-off sales at these retailers increased 20% compared to a statewide decrease of 1% for all other retailers. Assuming the average increase of 20% in scratch-off ticket sales at these retailers was primarily due to vending machine sales, the Lottery achieved nearly \$12 million more in transfers to education.⁷ Moreover, the vending machines provide players convenient access to a larger selection of games; transmit sales data in real-time, allowing the Lottery to better track ticket sales; and improve retailer operational efficiency.

New Lottery games could generate substantial revenues but would represent expanded gambling

Florida could consider adding several lottery games that could attract new players and substantially increase state revenues, although some of these games have drawbacks. For example, Florida could introduce fast keno (a quick draw lottery game), which could generate between \$49 million and \$269 million in additional transfers.^{8,9} Thirteen US lotteries offered fast keno in Fiscal Year 2008-09. Implementing fast keno would not violate the terms of the gaming compact between the State of Florida and the Seminole Tribe of Florida, unless it were offered on video lottery terminals.^{10,11} The Legislature would need to grant budget authority for the Lottery to spend sales revenue to acquire a fast keno gaming system.

Another game option that would not violate the gaming compact would be the multi-state Mega Millions game, which operates similar to Powerball. Multi-state lottery associations permitted states to cross-sell Powerball and Mega Millions starting in January 2010. All state lotteries except California, Florida, and

⁵ On May 27, 2009, the Lottery received spending authority to lease 1,000 vending machines.

⁶ [Section 24.105\(9\)\(a\)4, F.S.](#), provides that the only player-activated machine which may be utilized is a machine which dispenses instant lottery game tickets following the insertion of a coin or currency by a ticket purchaser.

⁷ OPPAGA's estimate is based on average weekly scratch-off sales 44 weeks prior to and after deployment (mid-October 2009) of the 1,000 instant ticket vending machines. According to Lottery officials, no other obvious factor than the deployment of instant ticket vending machines appear to account for the increase in sales at these retailer locations.

⁸ Fast keno, or a quick draw lottery game, is an on-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by a central computer. Fast keno is similar in principle to other on-line games, but occurs more frequently (typically every five minutes) and is often played in a social setting such as a bar or restaurant.

⁹ We estimated a range of potential fast keno revenue based on the highest and lowest per capita sales in states that offer fast keno after excluding outlier states from the upper and lower quartiles. We used a transfer rate of 30.38%. This rate was determined by the Lottery based on the average fast keno payout in other states of 60.62% and an administrative expense rate of 9%.

¹⁰ A gaming compact between the State of Florida and the Seminole Tribe of Florida was approved by the Governor April 7, 2010, ratified by [Ch. 2010-29, Laws of Florida](#), and approved by the U.S. Department of the Interior on July 6, 2010. The gaming compact provides the Tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gambling proceeds.

¹¹ Video lottery terminals are player activated and can be programmed to play casino-style games such as poker, blackjack, fast keno, and bingo; or simulate mechanical slot machines or roulette wheels.

Louisiana, are selling both multi-state games. However, based on a year of sales data in other states, the Lottery's on-line gaming system vendor (GTECH) determined that adding Mega Millions to the Florida Lottery's game portfolio would result in little to no gain in total on-line sales and education transfers. GTECH reports that though total jackpot-adjusted multi-state game sales have grown on average over the past year, the likely shift in sales on in-state lottery and cash games would present a unique problem for the Florida Lottery given the strength of the other games in their on-line portfolio. The Florida Lottery should continue to periodically assess the option of adding the Mega Millions game and its affect on the Lottery's overall transfers to education.

Introducing video lottery terminals statewide is another option that could be considered, but would violate the terms of the gaming compact.¹² As a result, there would be some offsetting revenue losses that would affect whether the state achieves a net revenue increase. The compact states that in the event the state authorizes expanded gaming beyond what was legal at the time of the signing of the compact agreement, such as video lottery terminals, payments due to the state may cease or be reduced. Florida could implement video lottery terminals in several ways, some of which have greater potential to result in a net revenue increase after accounting for lost revenue from the gaming compact (see Appendix D for more information).

- **Bingo only.** The estimated net revenue impact would range from a loss of \$69 million to a gain of \$77 million.
- **Class II, not limited to Bingo.** The estimated net revenue impact would range from a loss of \$52 million to a gain of \$111 million.

- **Class III Slot Machines.** The estimated net revenue impact would range from a gain of \$6 million to a gain of \$224 million.^{13, 14}

However, adding new lottery games would represent an expansion of legalized gambling and could produce negative social costs.¹⁵ Video lottery terminals and fast keno are considered to be more addictive than traditional lottery games because of their fast play pace. They could contribute to problem and pathological gambling rates and increase law enforcement costs to combat crime typically associated with gambling.

New ticket selling methods could also generate additional revenues

The Legislature and the Lottery could consider expanding product distribution by using new types of vending machines or selling lottery tickets over the Internet. Several of the top performing state lotteries are using new vending machine technology to dispense on-line games.¹⁶ The Florida Lottery is not authorized to use vending machines to dispense on-line game tickets because the law was written before such technology existed and specifically restricts player-activated games. Authorizing player-activated vending machines for on-line games could facilitate the recruitment of large corporate accounts such as

¹³ OPPAGA's video lottery terminal revenue estimate assumes 1,000 video lottery terminals are active a full year in 19 pari-mutuel facilities operating outside Broward and Miami-Dade counties. The estimates are based on Florida's lowest pari-mutuel net income per slot machine to the highest net income per slot machine. We then adjusted these figures to a 35% tax rate and compensated for shifts from other state revenue sources including the Lottery, sales tax, and slot machine tax.

¹⁴ As defined by the Indian Gaming Regulatory Act (25 U.S.C. 2703), class II gaming means the game of chance commonly known as bingo (whether or not electronic, computer, or other technologic aids are used in connection therewith) whereas class III gaming means all forms of gaming that are not class I gaming or class II gaming.

¹⁵ For more information see our 2010 report, *Lottery Profits Flat: Increasing Retailer Outlets is Critical to Increasing Sales*, OPPAGA [Report No. 10-16](#), January 2010.

¹⁶ Based on per capita sales, top-performing state lotteries that are beginning to use on-line vending machines include Georgia, Michigan, and New Jersey.

¹² Six states offered video lottery terminals in 2008-09.

Walgreens and Walmart.¹⁷ Full-service vending machines (i.e., selling both on-line and scratch-off games) may be attractive to large corporate chains, as they minimize on-site required labor and provide increased player choice and the potential for larger sales. In April 2010, the Lottery estimated that placing full-service machines in new retailer locations could generate between \$11 million and \$75 million in additional transfers to education.

Another product distribution option is to authorize player-activated vending machines for electronic instant ticket games rather than only offering vending machines that dispense paper instant tickets. Electronic instant vending machines could facilitate expansion into non-traditional retailer locations such as bars and restaurants. These machines require players to touch a video screen and view the image of the instant ticket on the screen to reveal the outcome of the ticket. These devices would not violate the revenue sharing terms of the gaming compact if not more than 10 machines are installed at any location and machines are not installed at any licensed pari-mutuel facility. In April 2010, the Lottery estimated that 2,000 electronic instant ticket vending machines could generate between \$33 million and \$114 million in additional transfers to education.

Selling Lottery products over the Internet is another option that could increase sales, but legal barriers would need to be addressed, including restrictions regarding the use of credit cards for lottery purchases, the challenge of ensuring that Internet sales are made within Florida's borders, and the potential effect on the gaming compact with the Seminole Tribe of Florida.

Other states that permit player-activated terminals sell subscriptions for certain on-line games over the Internet, but do not offer individual on-line or scratch-off tickets.¹⁸ For

instance, New Hampshire sells Mega Millions, Powerball, and Tri-State Megabucks subscriptions over the Internet, but requires a New Hampshire mailing address and a charge card to make the purchase. Florida law currently restricts the use of player-activated terminals and does not authorize the use of credit cards for lottery purchases without a purchase of \$20 in other goods. According to Lottery estimates, if Florida performed at average levels, annual sales through subscriptions could generate an additional \$10 million in transfers to education.

There are conflicting interpretations about whether federal law authorizes Internet sales of lottery products. Currently, no U.S. lottery is selling individual lottery tickets over the Internet. British Columbia, however, offers Internet-based games, using computer infrastructure to ensure player identification and location.

Proponents argue that federal law may be interpreted to allow intrastate Internet gambling as long as a bet is initiated, received, and paid within the same state. This would require enhanced technology to ensure that sales are made within a state's borders. However, opponents contend that it is not feasible to ensure that Internet lottery sales occur only intrastate because data transmitted by the Internet likely crosses state lines. Internet sales could provide players with increased access but, given the convenience and privacy of play, may also increase associated negative social consequences.

Further, authorizing the sale of Lottery products over the Internet has the potential to affect revenues from the gaming compact depending on whether the Tribe chooses to also offer Internet gaming. If only the state offers this option and the Tribe's net win of covered games drops more than 5% below its net win from the previous 12-month period, the Tribe would no longer be required to make guaranteed minimum payments to the state. Instead, the

¹⁷ Currently, Walgreens and Walmart do not sell lottery products anywhere in the U.S., but the Florida Lottery continues to pursue these retailer outlets.

¹⁸ Subscription sales permit players to order a number of on-line

game drawings at a time, such as 26 or more game drawings, and charge the purchase to a credit card through the lottery's website.

Tribe would continue to make payments based on the percentage revenue sharing amount. However, if the Tribe also offers Internet gaming, as authorized by law, state revenue from the compact would not be affected.

Increasing the retailer network would expand product distribution and avoid legal barriers

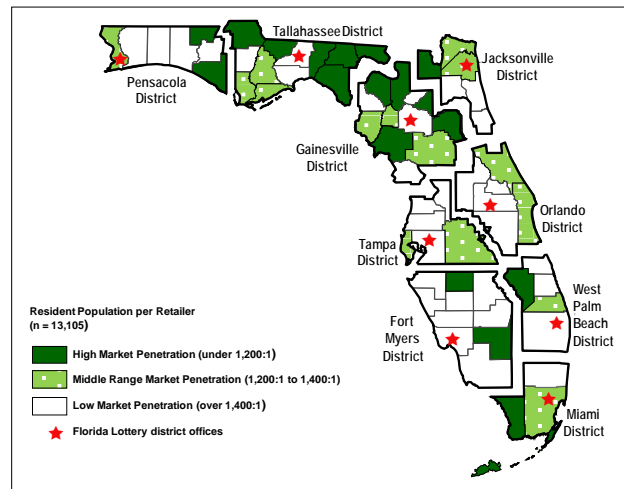
Increasing the number of retailers that sell lottery tickets has the potential to increase revenues by making Lottery products more readily available to residents and tourists. Nationwide data on state lotteries shows that there is a significant relationship between per capita sales and the number of residents per retailer, with states achieving higher sales when they have more retailers per 10,000 residents.

In Fiscal Year 2008-09, the top 10 U.S. lotteries ranked by per capita sales had an average of 1,200 residents per retailer. During that period, the Florida Lottery averaged 1,400 residents per retailer, and ranked 12th among U.S. lotteries in per capita sales. The previous year, Florida ranked 10th among the nation’s top performing lotteries. To meet the top-performing states’ average market penetration, the Lottery would need to expand its retail network from 13,100 to 15,400 retailers. Adding 2,300 new retailers has the potential to generate about \$33 million annually in additional transfers to the Educational Enhancement Trust Fund.¹⁹

The Lottery’s current market penetration rate varies across the state with pockets of the highest market penetration typically found in rural counties, as shown in Exhibit 2. Approximately half (34) of Florida’s 67 counties have low market penetration, including highly populated urban counties such as Broward, Hillsborough, Orange, and Palm Beach. These areas represent the greatest opportunity for expanding the department’s retailer network.

¹⁹ OPPAGA’s estimate is based on new retailers achieving at least the median average weekly gross sales for new retailers in 2009-10. The estimate assumes all 2,300 terminals being active for a full year and that 20% of their sales would be shifted from existing retailers.

**Exhibit 2
Retailer Market Penetration Varies
Across the State**



Source: OPPAGA analysis of Florida population and Lottery retailer data.

The department has recruited additional retailers but also has lost many due to factors including the current economic conditions, which have forced some participating businesses to close. After losing 86 retailer outlets in Fiscal Year 2008-09, retailer rates remained relatively flat in Fiscal Year 2009-10. The Florida Lottery began Fiscal Year 2009-10 with 13,134 active retailers and ended with 13,138, for a net gain of 4 new retailer outlets across the state.

The department addressed OPPAGA’s recommendations to strengthen recruitment efforts. Consistent with our recommendations, the Office of Business Development began targeting retailer recruitment efforts to areas with low retailer penetration and very recently completed a cost-benefit analysis of its retailer recruitment efforts. The department should use this study to identify which retailer recruitment activities work best in different areas of the state and determine an acceptable cost per new retailer recruited. OPPAGA will monitor how the department uses the cost-benefit analysis data to manage and/or modify its retailer recruitment efforts and whether the department, as recommended, regularly updates the analysis.

The department has continued to use recruitment seminars to increase the retail network, hosting two in Fiscal Year 2009-10. In 2010 both OPPAGA and the Department of the Lottery's Inspector General expressed concern about the return on investment of this recruiting technique. OPPAGA noted that the department had not captured all related expenses to host the seminars and was unable to measure their total costs, while the department's inspector general determined that the seminars produced a limited return on investment when compared to other recruitment activities. The Office of Business Development disagrees; it asserts that the seminars help bring in retailers and develop leads for future follow-up. The office reports that it will continue to host seminars, as directed by executive management, as strategic outreach in specific districts/regions.

The Office of Business Development also has begun to conduct district outreach missions, which it believes could achieve comparable results to outreach seminars at a lower price. Rather than the two months required to plan a retailer recruitment seminar, office staff spend three to four weeks making phone calls to set up face-to-face meetings with prospective independent retailers in areas of low penetration. At least one person from the headquarters' Office of Business Development travels to the district for these meetings with the goal of collecting the retailer's application on-site. The headquarters staff are frequently accompanied by someone from the local district office to conduct the face-to-face retailer meetings.

Headquarters and district administrators have varying views about the implementation of the retailer recruitment outreach missions. District managers believe that the outreach missions could be handled at the local level by district sales representatives who will serve as the face-to-face support and contact for local retailers. They reported that on-site staff are in a better position to identify viable new retailers because they are more knowledgeable about the

retailers in their areas and these retailers' potential to successfully sell Lottery products. On the other hand, the Office of Business Development believes that the headquarters outreach missions result in more retailer applications and faster signed retailer contracts. The cost information recently collected to conduct a cost-benefit analysis of the department's recruitment efforts should provide baseline information to assess the cost efficiency of outreach mission implementation.

The department should use retailer recruitment cost-benefit analyses as an ongoing feedback loop to plan recruitment activity and give the department an overall perspective on the effectiveness and cost efficiency of its recruitment efforts.

Operational Efficiency Options—

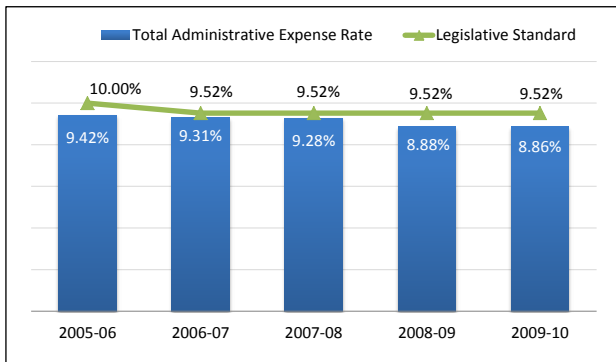
The Lottery continues to improve on a key indicator of operational efficiency, expenses as a percentage of sales. However, it could realize additional efficiencies by ensuring that retailer commissions represent the best value for the state and continuing to explore ways to reduce costs for headquarters office and warehouse space.

The Lottery's administrative expense rate is lower than the legislative standard and has continued to decline

The Lottery's administrative expenses in relation to its ticket sales continue to be lower than the legislative standard and this rate has declined over time, as shown in Exhibit 3. The most recent decline is due to lower vendor commissions. Compared to other U.S. lotteries, the Lottery had the 3rd lowest expense rate (8.93%) in Fiscal Year 2008-09 behind New Jersey (8.47%) and Massachusetts (8.26%).²⁰

²⁰ Florida Lottery's ranking is based on the latest fiscal year data available from La Fleur's 2010 World Lottery Almanac.

**Exhibit 3
The Lottery’s Administrative Expense Rate Has Declined Over Time**

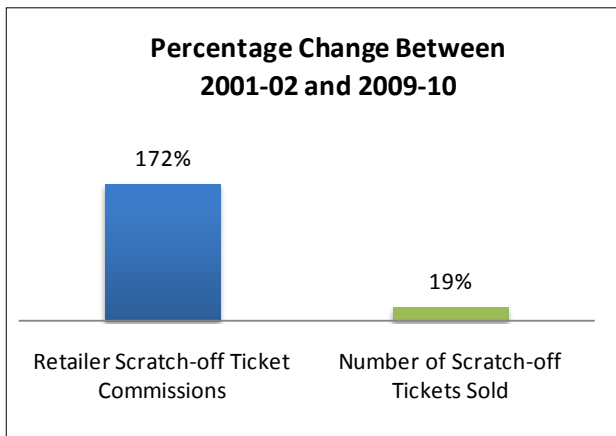


Source: OPPAGA analysis of Lottery financial data, the General Appropriations Act, and agency Long Range Program Plans.

Retailer commissions could be modified to reduce costs

While the Lottery’s administrative expense rate is low, the actual dollars spent on retailer scratch-off commissions has increased substantially and disproportionately to the volume of tickets sold. Scratch-off sales commissions to retailers increased by 172% between Fiscal Years 2001-02 and 2009-10, while the number of scratch-off tickets sold increased by only 19% during this period (see Exhibit 4). This is a result of commissions being tied to the dollar value of tickets sold rather than to the number of tickets sold.

**Exhibit 4
Retailer Commissions Increased Substantially and Disproportionately to the Volume of Tickets Sold**



Source: OPPAGA analysis of Lottery financial data.

The Lottery’s retailer compensation structure, which includes three payment components, has been in place since its inception in 1987 and includes

- a sales commission of 5% of the sales price of every ticket sold by a retailer;
- a 1% prize redemption payment applied to the value of the prize being redeemed; and
- special retailer incentive payments, such as incentives for sales of a new lottery game during the early weeks of its launch or for achieving a pre-determined sales goal.²¹

Each of these three retailer compensation components disproportionately pays retailers for their efforts. For example, retailers incur essentially the same costs to sell all tickets, though they receive higher commissions without increased labor costs when they sell higher priced tickets. When the retailer sales commission of 5% was established, the Lottery was limited to selling \$1 tickets. With the Legislature’s authorization of variable prize payouts in 2002, the Lottery started selling higher priced scratch-off tickets, including \$10 and \$20 games. As a result, scratch-off sales commissions now range from the original 5 cents for selling a \$1 ticket to 50 cents, and \$1 for \$10 and \$20 tickets. A similar disproportionate relationship exists between the prize redemption payment and the value of the prize. For example, retailers are paid 1 cent for redeeming a \$1 prize and \$6 for redeeming a \$599 prize, though the labor required to redeem prizes is the same regardless of the ticket value. Further, bonus payments are paid to retailers who sold winning tickets though winning tickets are random and do not reflect retailer performance.

In 2007, OPPAGA recommended using alternative retailer payment terms in future contracts to attract and retain quality retailers while maximizing revenues to the state. These alternative payment terms include fixed fees

²¹ Florida Lottery retailers are authorized to cash prizes up to \$599.

with incentive payments, staggered commission rates, and commission caps.²² The 2009 Legislature required the Lottery to study the retailer commission structure and develop alternatives for rewarding retailer performance, such as using a fixed fee payment structure based on the number of tickets sold and providing an incentive for exceeding performance targets to attract and retain quality retailers.

The Lottery published its study in January 2010. The study identified eight alternatives for retailer compensation programs (see Appendix F for a summary of each alternative). The Lottery's study included surveying and conducting focus groups with retailers to identify their compensation preferences.

However, the department's 2010 study does not include a cost and feasibility analysis for any of the retailer compensation alternatives. Instead, the Lottery reports that this analysis will be completed separately at a later date. The analysis was not available at the time of this report.

Retailer compensation should be structured to reward retailers for delivering agreed-upon services and provide incentives to encourage retailers to help maximize transfers to the Educational Enhancement Trust Fund. Because the Lottery cannot predict the potential impact on commissions from changes such as increasingly higher priced scratch-off tickets or expanding multi-priced on-line games, it should adopt a retailer payment structure that is fair and proportionate to the level of service effort, rewards retailers for exceeding performance targets, and allows the Lottery to respond to new opportunities without disproportionate increases in retailer commissions.

Major reconstruction to consolidate headquarters space results in a net loss; other options are more cost effective

Since the late 1990s the Lottery has reduced its need for office and warehouse space at its headquarters location through staff reductions of 50% and outsourcing of in-house functions including telemarketing and scratch-off ticket distribution. However, the Lottery has not commensurately lowered its operational costs by reducing the amount of space it leases. For Fiscal Year 2009-10, the Lottery paid \$496,000 to lease about 30,600 square feet of excess office space. To address this issue, the Legislature directed the Lottery to develop a plan to consolidate its leased office space where economical and to sublet excess office and warehouse space to suitable tenants.

In 2010, the Lottery hired an architect to develop a space consolidation plan and to estimate the income and expenses for two options: (1) subleasing 12,035 square feet of office space on the ground floor and 4,957 square feet of air conditioned warehouse space in the basement; and (2) subleasing 8,575 square feet of office space in the basement. The analysis concluded that the estimated cost to consolidate Lottery's excess leased space exceeded the potential sublease income and it would not be profitable for the department to lease its excess space.²³

²³ EMO Architects' consolidation plan identifies the areas that could potentially be considered for consolidation and the areas that could potentially be suitable for sublease. In order to sublease excess leased space, EMO Architects estimated that the construction and related costs to convert the headquarters facility from a single tenant to a multi-tenant facility would be about \$1.1 million to \$3 million depending on the consolidation approach. EMO Architects also estimated build-to-suit costs of \$40 per square foot to finish the space vacated by Lottery operations, resulting in an additional expense of \$340,000 to \$680,000. Cushman & Wakefield of Florida, Inc., under contract with the Lottery as its tenant broker, estimated sublease income at about \$12 to \$13 per square foot of blended office and warehouse space, and market brokerage fees equal to 4% of the aggregate value of the sublease. Thus, the total costs of consolidating office space were estimated to be \$1.5 million to \$3.7 million, compared to sublease income of \$500,000 to \$1.1 million.

²² For more information on options, see *Lottery Scratch-Off Sales Increase; Options Available to Enhance Transfers to Education*, OPPAGA Report No. 07-09, February 2007.

The Lottery retained the right to terminate the current headquarters lease without penalty in the event a state-owned building becomes available in Leon County. In Fiscal Year 2009-10, the Lottery's effective leased office space rate of \$21.49 per square foot is \$4.31 per square foot more than the state's uniform full-service rental rate of \$17.18 for state-owned office space.²⁴ That is, the Lottery is paying \$556,000 more per year to lease space in the private sector instead of state-owned office space. Therefore, the Lottery should continue to work with the Department of Management Services to monitor and evaluate the suitability of state-owned office space as it becomes available.

The department is updating its field service business case to assess the option of outsourcing, but results are not yet available

The Florida Lottery spends approximately \$10.8 million annually for field support services across the state. This includes approximately 113 sales representatives that service individual lottery retailers, 12 field sales managers that supervise the field support staff, and 5 sales executives that service and support corporate chain accounts. In 2010, OPPAGA found that at least six other state lotteries outsourced all or part of their field support staff, and outlined pros and cons associated with outsourcing these services. We recommended that the Lottery update its field support business case study to clearly define its operations and related costs, identify potential operational efficiencies, and assess the risks and benefits of outsourcing field support services. The department is updating the business case study and it expects that the report will be available in 2011.

²⁴ The Lottery's headquarters lease is for office and warehouse space at a blended lease rate. To determine the Lottery's effective office lease rate, we converted this blended lease rate to a separate warehouse and office lease rate using the Department of Management Services uniform air-conditioned warehouse rate of \$5.11 per square foot.

Recommendations

In Fiscal Year 2009-10, the Lottery transferred \$1.2 billion to the Educational Enhancement Trust Fund, \$41 million less than in 2008-09. Declining sales are expected to continue before slightly increasing in the 2012-13 fiscal year. While the department and the Legislature have taken steps to increase transfers to education, there are additional actions that could increase sales, reduce administrative expenses, and ultimately increase transfers to education.

Department Recommendations

We recommend that the Department of the Lottery take several steps to enhance its revenues and increase its operational efficiency.

- Evaluate the benefits of adding a fast keno game and continue to assess the option of offering another multi-state lottery game. Introducing fast keno has the potential to significantly increase transfers to education, while offering a second multi-state super jackpot game could also increase transfers to education. The Lottery should carefully evaluate the benefits of offering fast keno and another multi-state game and provide the results to the Legislature.
- Annually complete retailer recruitment cost-benefit analyses and use these analyses to adjust recruitment efforts. The department should annually complete its retailer recruitment cost-benefit analysis and use the resulting data to evaluate the cost efficiency of recruitment activities, adjust these efforts as needed, and plan future activities.
- Complete its examination of the retailer commission structure and report results to the Legislature. The department should complete its assessment of the costs and feasibility of alternative retailer commission payment structures, such as prize cashing bonuses and incentives to reward retailers for performance that reflects the volume of tickets sold and prizes redeemed and their contribution to education. The Lottery should present its findings to the Legislature.

- Work with the Department of Management Services to reduce excess office space. The Lottery should work with the Department of Management Services to monitor and evaluate the suitability of state-owned space as it becomes available.

Legislative Options

The Legislature could consider authorizing the Lottery to expand its current games and product distribution methods to enhance revenues.

- Authorize the Lottery to offer on-line game and electronic instant ticket vending machines. The Legislature could consider authorizing the department to use vending machines to distribute on-line products. Vending machines selling both scratch-off and on-line games have the potential to appeal to large corporate retailers not currently distributing Lottery products. The Legislature could also authorize the Lottery to use electronic instant ticket vending machines to expand product distribution to bars and restaurants.
- Consider authorizing the Lottery to offer Internet sales. The Legislature could consider selling Lottery products over the Internet, but would need to address several

barriers, including restrictions regarding the use of credit cards for lottery purchases, the challenge of ensuring that Internet sales are made within Florida’s borders, and the potential effect on the gaming compact with the Seminole Tribe of Florida.

- Consider authorizing new games. The Legislature could consider authorizing and granting budget authority to expand video lottery terminals statewide. The Legislature also could consider granting budget authority to the Lottery for a fast keno gaming system. These games have the greatest potential to significantly increase transfers to education; however, they are considered more addictive than Florida Lottery’s current games and authorizing video lottery terminals would violate the revenue sharing agreement with the Seminole Tribe of Florida.

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 F.

OPPAGA supports the Florida Legislature by providing data, evaluative research, and objective analyses that assist legislative budget and policy deliberations. 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 (850/487-9213), 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.

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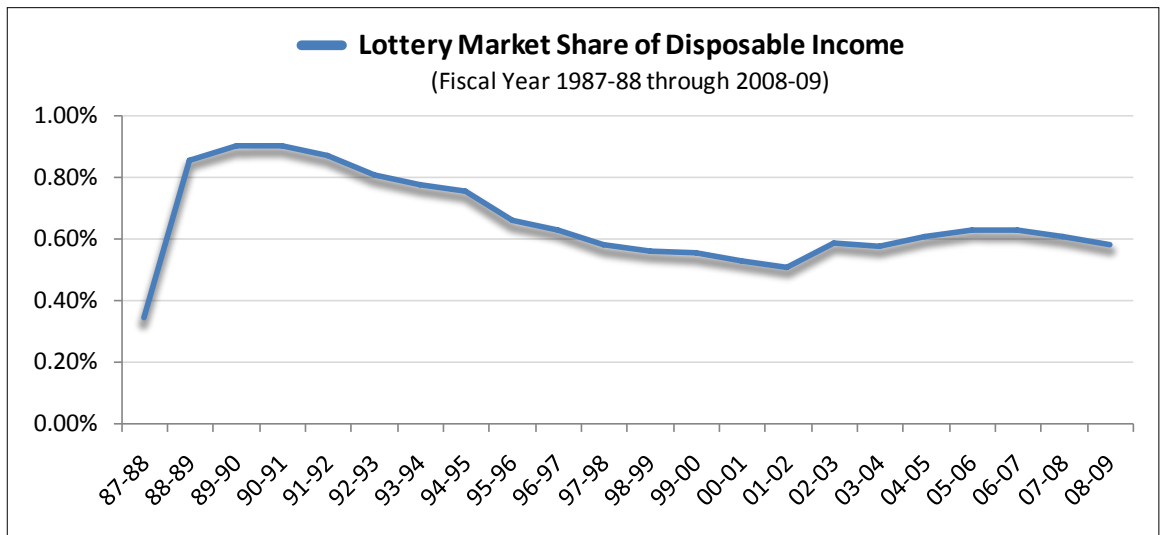
Kathy McGuire, OPPAGA Interim Director

Appendix A

Lottery’s Share of Disposable Personal Income

Disposable personal income is the total personal income available to individuals for spending or saving after paying government taxes. Businesses use personal income estimates to plan activities, which might include evaluating markets for new or established products or determining areas for a business to locate, expand, or contract. Table A-1 shows the Lottery’s per capita net sales (not adjusted for inflation) as a percentage of per capita disposable personal income (also not adjusted for inflation). The table shows that, as the Lottery matured, its share of disposable personal income declined until variable prize payouts were authorized in 2002, which helped to increase the sale of scratch-off products and higher priced scratch-off tickets. In Fiscal Year 2008-09, the Lottery ranked 13th in per capita net sales as a percentage of per capita disposable personal income among U.S. lotteries.

Table A-1
Lottery Share of Disposable Personal Income Started to Decline Again in Fiscal Year 2007-08



Source: US Department of Commerce, Bureau of Economic Analysis; Florida Demographic Estimating Conference population estimates; and Lottery net sales data.

Appendix B

New Lottery Game Options

New games that attract new players have the potential to substantially increase revenues to the Lottery. While the Legislature could consider authorizing the Lottery to offer new games such as video lottery and a fast keno game, these options would likely increase the negative social costs of gambling and, in some cases, conflict with the gaming compact between the State of Florida and the Seminole Tribe of Florida. Table B-1 lists these and other game options that could increase Lottery sales and transfers to education, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates.

**Table B-1
New Games Could Raise Over \$263 Million for Education**

Option	Advantages	Disadvantages
<p>Video Lottery Terminals Players use video terminals that can be programmed to play casino-style games such as poker, blackjack, fast keno, and bingo, or simulate mechanical slot machines or roulette wheels</p>	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from a loss of \$69 million to a gain of \$224 million per year depending on how it is implemented and after accounting for lost Seminole Tribe of Florida gaming revenue for violating the terms of the revenue sharing agreement ▪ To reduce issues/concerns about underage players, play could be limited to pari-mutuel facilities such as racetracks or establishments with liquor licenses 	<ul style="list-style-type: none"> ▪ Because of its rapid play style, it may be more addictive than other lottery games increasing social costs associated with problem and pathological gambling ▪ Would violate revenue sharing gaming compact between the state and the Seminole Tribe of Florida ▪ Represents a substantial change for gambling in Florida by permitting casino-style lottery games statewide and could be criticized by anti-gambling groups ▪ Would require legislative action to legalize player-activated terminals in Florida (s. 24.105, <i>F.S.</i>) ▪ Requires legislative budget approval for a video lottery gaming system ▪ If launched in racinos (i.e., horse or dog race tracks with casinos), it could erode sales of traditional Florida Lottery games within certain market segments. ▪ Could be considered an expansion of gambling
<p>Fast Keno On-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by the central computer at Lottery headquarters; may be played frequently (e.g., every five minutes) on monitors in social settings such as bars or restaurants.</p>	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$49 to \$269 million per year ▪ Can be limited to existing areas where betting is allowed such as pari-mutuel facilities or social settings such as bars and restaurants ▪ Implementing fast keno would not violate the terms of the gaming compact between the state and the Seminole Tribe of Florida, unless it were offered on video lottery terminals 	<ul style="list-style-type: none"> ▪ Fast keno is more addictive than traditional lottery games, though not as addictive as video lotteries ▪ Could be considered an expansion of gambling ▪ Would require legislative action to modify the requirement for a drawing to be witnessed by an accountant given electronic drawings could occur every five minutes (s. 24.105(9)(d), <i>F.S.</i>) ▪ Requires legislative budget approval for a fast keno gaming system

Option	Advantages	Disadvantages
<p>Daily Keno On-line lottery game in which players choose as many as 10 numbers from a panel of 80 numbers in the hope of matching their choices to those drawn by the central computer at Lottery headquarters; similar in principle to other on-line games and it may be played weekly or daily</p>	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$6 to \$11 million per year 	<ul style="list-style-type: none"> ▪ Could be considered an expansion of gambling
<p>Mega Millions Powerball states and Mega Millions states now have the authority to cross-sell game</p>	<ul style="list-style-type: none"> ▪ Offers players greater opportunities for very large jackpots ▪ Potential recurring transfers to education may be positive but are indeterminate at this time 	<ul style="list-style-type: none"> ▪ More frequent mega jackpots could reduce incentive for occasional players to respond to large jackpots ▪ Probable sales shift from Powerball and Florida Lotto ▪ Could be considered an expansion of gambling
<p>Higher Priced Scratch-off Games As the economy strengthens or the value of the dollar depreciates, higher priced scratch-off games can be offered (e.g., \$50 games)</p>	<ul style="list-style-type: none"> ▪ Since 2002, most scratch-off growth in transfers to education in Florida has been due to higher price point games. Compared to other states offering high priced tickets, Florida is an industry leader in the \$20 scratch-off game. 	<ul style="list-style-type: none"> ▪ Higher priced scratch-off games are contingent on the strength of the economy ▪ Florida's experience with \$30 tickets was not encouraging and the growth in scratch-off sales has begun to level off, indicating there are limits to what will sell. ▪ Only seven states have offered scratch-off tickets over \$20 dollars, including Connecticut, Florida, Indiana, New Hampshire, New York, Pennsylvania, and Texas. Texas offers the only \$50 game.
<p>Monitor Games Computer animated games simulating horse racing, golf, etc., that are played on in-store monitors similar to the way fast keno is played</p>	<ul style="list-style-type: none"> ▪ May have less association to casino gambling than fast keno ▪ Could appeal to emerging markets of Lottery players that have grown up playing computer games ▪ Allows the Lottery to recruit new retailers in social venues such as bars and restaurants 	<ul style="list-style-type: none"> ▪ Because of its rapid play style, it could be more addictive than traditional lottery games ▪ Could be considered an expansion of gambling
<p>Interactive Games Players purchase a ticket at a Lottery retailer and take it home to play an interactive game on the Lottery website or through a CD-Rom.</p>	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$4 million to \$6 million per year. ▪ Play style offers more intrinsic value than a traditional paper lottery ticket and may be more marketable ▪ Attractive to the young adult market (20 to 34 years old) ▪ Can have validation codes to prevent underage gambling and underage players would not be permitted to redeem tickets even if they played the CD 	<ul style="list-style-type: none"> ▪ Higher operational costs than other scratch-off style games ▪ Could lose some entertainment value since gratification is deferred, as players must play the game on a computer, not on the premises ▪ May increase underage gambling by appealing to younger market segments ▪ Could be considered an expansion of gambling

Source: OPPAGA analysis of industry and Lottery information.

Appendix C

Product Distribution Options

Increasing the number of retailers has the potential to increase revenues by making lottery products more readily available to residents and tourists and has been shown to drive lottery sales more than advertising or jackpot size. Florida’s retailer penetration rate lags behind that of the top performing states. New equipment such as on-line vending machines and product distribution through the Internet could also increase the number of retailers and subsequent revenue. Table C-1 lists these and other product distribution options that could increase Lottery sales and education transfers, their advantages and disadvantages, and estimated revenues where we were able to develop reasonable estimates. The estimated revenues are based on individual options; if multiple options were implemented concurrently, the fiscal impact of each would likely be smaller due to shifts in sales from one game to another.

Table C-1
Expanding Product Distribution Could Raise Over \$33 Million for Education

Option	Advantages	Disadvantages
<p>Expand Retailer Network Add additional corporate and independent Lottery retailers in both traditional locations such as convenience and grocery stores and non-traditional locations such as airports, hotels, and restaurants</p>	<ul style="list-style-type: none"> ▪ Should result in incremental sales increases if terminals are placed in the right retailer locations ▪ Florida has been below the average in terminal density compared to other successful Lottery states so expanding its network should improve per capita sales ▪ Could increase product distribution and awareness, making products available to new players that don't shop where products are currently being sold ▪ Adding 2,300 new retailers has the potential to generate about \$33 million annually in additional transfers to the Educational Enhancement Trust Fund 	<ul style="list-style-type: none"> ▪ Requires legislative budget approval for more terminals ▪ Retailer expansion has been difficult during recession because retailer closings have been higher than new retailers recruited ▪ The non-traditional lottery business model may require the development of different products and distribution strategies ▪ May require additional lottery staff to service new accounts
<p>Electronic Instant Ticket Vending Machine Players touch a video screen and receive the image of the instant ticket on the screen to reveal the outcome of the ticket</p>	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$33 million to \$114 million per year depending on how it is implemented ▪ Provides a business model allowing retailer network expansion into non-traditional retailer locations, such as bars and restaurants 	<ul style="list-style-type: none"> ▪ Would violate revenue sharing gaming compact between the state and the Seminole Tribe of Florida if these devices are deployed at any licensed pari-mutuel facility or if more than 10 machines are installed at any location ▪ Requires legislative budget approval for more instant ticket vending machines ▪ Requires monitoring of underage play ▪ Some stakeholders criticize the potential ease of access by problem gamblers
<p>Expand Instant Ticket Vending Machines (ITVMs) Self-service vending machines for scratch-off tickets are installed in approximately 1,500 Lottery retailers</p>	<ul style="list-style-type: none"> ▪ Allows additional product access at high volume Lottery retailers ▪ Latest technology provides improved functionality, better security, and better accounting ▪ Early instant ticket vending machine sales show increases in retailer sales where ITVMs are deployed ▪ Could be cost-effective where scratch-off tickets are not being sold, such as in hotels and restaurants 	<ul style="list-style-type: none"> ▪ Requires legislative budget approval for more ITVM units ▪ Requires monitoring of underage play ▪ Some criticize the potential ease of access to problem gamblers

Option	Advantages	Disadvantages
<p>Authorize Full-Service Vending Machines The Legislature would amend the law to permit player-activated vending machines that are capable of selling on-line quick pick tickets</p>	<ul style="list-style-type: none"> ▪ Provides more convenience to players who do not want to stand in line to purchase tickets ▪ Successful in other Lottery states ▪ May attract large corporate retailers currently not selling Lottery products ▪ Allows retailer network expansion into non-traditional retailer locations (e.g., in airports and hotels) ▪ Would not require a modification to the Lottery retailer contracts that require retailers to carry both scratch-off and on-line games ▪ Potential transfers to education range from \$11 million to \$75 million annually 	<ul style="list-style-type: none"> ▪ Requires a statutory change to allow player-activated terminals for on-line games (s. 24.105, <i>F.S.</i>) ▪ Requires legislative budget approval ▪ Requires monitoring of underage play ▪ Some criticize the potential ease of access by problem gamblers ▪ Could be considered an expansion of gambling
<p>Authorize Internet Sales The Legislature would enact laws to authorize intrastate Internet sales of Lottery products</p>	<ul style="list-style-type: none"> ▪ Provides more convenience to players who prefer to purchase their Lottery products from their personal computer or cellular device ▪ Canadian lotteries are selling individual games over the Internet using technology that detects the player's location (e.g., British Columbia Lottery Corporation at www.bclc.com) 	<ul style="list-style-type: none"> ▪ Would require ensuring that Internet sales are made within Florida borders ▪ Requires a statutory change to allow player-activated terminals (s. 24.105, <i>F.S.</i>) ▪ Requires legislative budget approval for enhanced systems and technology ▪ Use of credit cards for lottery purchases without purchase of \$20 in other goods would require a law change (s. 24.118, <i>F.S.</i>) ▪ Could be considered an expansion of gambling ▪ Could affect revenue from gaming compact between the state and the Seminole Tribe of Florida
<p>Subscription Play Players can subscribe to on-line game drawings for up to one year in advance on the Florida Lottery website</p>	<ul style="list-style-type: none"> ▪ Potential to generate about \$10 million annually in additional transfers to the Educational Enhancement Trust Fund ▪ Internet technology has made subscription services must easier and more cost-effective for lotteries to manage ▪ Key benefits for the consumers are no missed draws, no waiting in lines, and ease of prize claims ▪ Provides the ability for people to play who may not be able to otherwise, such as seasonal residents and physically challenged residents ▪ Subscription play is offered in about 15 U.S. lotteries 	<ul style="list-style-type: none"> ▪ Use of credit cards for lottery purchases without purchase of \$20 in other goods would require a law change (s. 24.118, <i>F.S.</i>) ▪ Requires legislative budget approval for enhanced systems and technology ▪ Must comply within federal laws that restrict subscriptions from out-of-state players unless they have in-state mailing addresses ▪ Game changes require communication with players and possibly a replacement ticket ▪ Because all prize payments will be paid automatically, subscription play would not generate revenues from unclaimed prize funds ▪ Could be considered an expansion of gambling

Source: OPPAGA analysis of industry and Lottery information.

Appendix D

Estimates of Net Revenues for Video Lottery Terminals

The Governor approved a gaming compact between the State of Florida and the Seminole Tribe of Florida on April 7, 2010, which was ratified by the Legislature in [Chapter 2010-29, Laws of Florida](#), and approved by the U.S. Department of the Interior on July 6, 2010. The compact provides the Tribe with partial but substantial exclusivity with respect to the play of covered games in exchange for payments to the state derived from gambling proceeds.

Introducing video lottery terminals statewide would violate the terms of the gaming compact, thereby creating offsetting revenue losses that would affect whether the state achieves a net revenue increase. The compact states that in the event that the state authorizes expanded gaming beyond what was legal at the time of the signing of the compact, such as video lottery terminals, Tribe gaming payments would cease. As shown in Table D-1, Florida could implement video lottery terminals in several ways, some of which have greater potential to result in a net revenue increase after accounting for lost revenue from the gaming compact.

Table D-1
Introducing Video Lottery Terminals Could Be a Revenue Gain or Loss Depending on Implementation (estimates in millions)

Revenue Source	Class II Bingo Only ¹		Class II Games ¹		Class III Slot Machines ¹	
	Low Estimate	High Estimate	Low Estimate	High Estimate	Low Estimate	High Estimate
Video Lottery Terminals ²	\$156.8	\$303.5	\$174.2	\$337.2	\$232.2	\$449.6
Indian Gaming Revenues ³	226.1	226.1	226.1	226.1	226.1	226.1
Net Revenue	-\$69.3	\$77.4	-\$51.9	\$111.1	\$6.1	\$223.5

¹ As defined by the federal Indian Gaming Regulatory Act, class II gaming means the game of chance commonly known as bingo (whether or not electronic, computer, or other technologic aids are used in connection with it), but may include other games of chance such as fast keno, whereas class III gaming means all forms of gaming that are not class I gaming or class II gaming (25 U.S.C. 2703).

² Our estimates of net revenue from video lottery terminals assumes 1,000 video lottery terminals are active a full year in 19 pari-mutuel facilities operating outside Broward and Miami-Dade counties. We developed the estimates based on Florida's lowest pari-mutuel net income per slot machine and the highest net income per slot machine. We then adjusted these figures to a 35% tax rate and compensated for shifts from other state revenue sources including the Lottery, sales tax, and slot machine tax.

³ The Revenue Estimating Conference met February 14, 2011, and adopted this estimate for Indian Gaming revenues in 2012-13.

Source: Revenue Estimating Conference and OPPAGA analysis.

Appendix E

Options the Lottery Identified in Its Review of Retailer Compensation

Lottery’s current retailer compensation structure disproportionately pays retailers for their efforts. In 2007, OPPAGA recommended using alternative retailer payment terms in its future contracts to attract and retain quality retailers while maximizing revenues to the state. The 2009 Legislature required the Lottery to study the retailer commission structure and develop alternatives for rewarding retailer performance, such as using a fixed fee payment structure based on the number of tickets sold and providing an incentive for exceeding performance targets to attract and retain quality retailers. In January 2010, the department issued a report that identified alternatives for its retailer compensation structure but has not yet completed a cost and feasibility analysis of these alternatives. Table E-1 provides an overview of the alternative retailer compensation programs the Lottery identified, ranked by the ratings of participants in retailer focus groups.

**Table E-1
The Lottery Identified Eight Options for Revising How Retailers Are Compensated for Their Services**

Compensation Program	Description of Option in Lottery’s January 2010 Report	Ratings Given by Retailer Focus Group Participants
Higher Prize Redemption Bonus	The Lottery increases the standard prize redemption bonus to retailers from the current 1% commission to a 2% commission. A number of U.S. lotteries pay higher cashing bonuses than Florida, and a few pay the percentage rate on redeemed prizes exceeding \$600 even if the ticket actually must be cashed in a lottery office.	Most Appealing
Graduated Compensation	Using quarterly changes in sales figures (percentage change from past quarters), retailers would be compensated at a higher rate if they out-perform the statewide average change in sales. Quarterly changes in sales would be measured at the statewide level and for each retailer, and the payment rate re-assessed each quarter. The Arizona, Colorado, Kentucky, and Montana lotteries use this method with some variations.	Appealing
Fixed Compensation Value Per Ticket	The Lottery would pay retailers a commission on a per-ticket basis rather than on a percentage-of-sales basis (which is how retailers are currently receiving commissions). Thus, retailers would be compensated on each Lottery ticket or play rather than on the amount of sales.	Medium Appeal
Clerk Targeted Incentives	<p>This program consisted of three options.</p> <ol style="list-style-type: none"> 1) The Lottery would pay a higher sales commission to retailers if the retailer agreed to split the incentive with the sales clerks or at least provide the clerks with some type of bonus for promoting the increase of lottery ticket sales. 2) Someone working for the Florida Lottery would act as a mystery shopper and reward clerks who ask customers if they want to purchase a ticket. An example reward would be a \$25 VISA gift card. Many state lotteries, including New York, North Dakota, and South Carolina, operate similar programs and point to it as their most effective strategy for incentivizing sales. 3) A promotional scratch-off game book would be given to a retail store. A sign would be displayed in the store for a given time period telling customers that if the sales clerk did not ask about purchasing a ticket, the customer would get one of the promotional game books for free. At the 	Some Appeal

Compensation Program	Description of Option in Lottery's January 2010 Report	Ratings Given by Retailer Focus Group Participants
	end of the time period, the store would keep the tickets that are not given away, and either retain any profits from their sale or receive the proceeds from their winnings.	
Best Practices Incentive	Retailers would formally agree to meet best practice standards in a contract and would be paid an additional one-half to one percentage point on sales for fulfilling the standards. Best practice standards might include making sure ticket dispensers are full at all times, ensuring signage for lottery tickets is prominently displayed, and activating new scratch-off games within 24 hours. The retailer would be under a contractual obligation to ensure these standards were met in order to receive the additional sales commission. The Lottery would send out mystery shoppers periodically throughout the year to ensure retailers who signed the contract are implementing the best practices. The Nebraska Lottery has a program like this for retailers agreeing to follow their merchandising plan.	Somewhat Appealing
Scratch-Off Game Settlement Incentive	The Lottery will set weekly scratch-off game book settlement goals. Retailers will receive a cash bonus for reaching or exceeding goals. In this way, retailers would have a built-in incentive for displaying and promoting the sale of scratch-off tickets quickly. The sales value for a book or packet of scratch-off tickets is not counted until that book is moved from activated status to settled status. This usually occurs when the tickets in the book are completely sold or when a large corporate retailer follows a routine practice of settling the book before placing it on display for sale. Once a book is placed in settled status, then the Lottery collects its share of the proceeds from the retailer by sweeping the retailer's lottery bank account, leaving behind the amount deserved by the retailer for sales commissions and cashing bonuses.	Guarded
Co-op Accrual Program	Retailers would receive the typical 5% sales commission directly, but would also receive an additional percentage point or part of a percentage point (exact figure to be determined) to be placed in an accrual fund. The money in the accrual fund would build up over time and spent when agreed to by the retailer and the Lottery. The money would be used for marketing, advertising, promotions, or sales materials for that particular store or corporation. The money in the fund could be used for marketing and promotions for non-lottery products as well or to promote the store itself. However, these efforts would need to coincide with promotions for lottery products.	Unappealing
Rewards Points Program	The retailers would receive rewards points for performance on overall sales, quick book activation, special in-store promotions, prize redemptions, displaying jackpot signage, ensuring ticket dispensers are full, etc. Rewards points would be accumulated over time and then redeemed for upgraded signage, radio remotes, Lottery premiums, co-op advertising, or other marketing materials that would help increase lottery sales in the retail store. The Connecticut Lottery has a similar premium points program.	Unappealing

Source: *Florida Lottery Retailer Compensation Study*, January 2010.

Appendix F

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY

February 25, 2011

Ms. Kathy McGuire
Interim Director
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Ms. McGuire:

Thank you for the opportunity to respond to your office's report: "Lottery Profits Decline; Options Available to Enhance Transfers to Education." I especially appreciate your providing additional time for me to review the draft report as the newly-appointed Lottery Secretary. Once again this year, we have organized our response around the "Department Recommendations" appearing at the end of the report.

Evaluate the benefits of adding a fast keno game and offering Mega Millions, another multi-state lottery game.

Introducing fast keno has the potential to significantly increase transfers to education, while offering a second multi-state super jackpot game could increase transfers to education. The Lottery should carefully evaluate the benefits of offering a fast keno and another multi-state game and provide the results to the Legislature.

Lottery Response: The evaluation of game options is an ongoing endeavor at the Florida Lottery. As the newly-appointed Secretary, I can assure you that we will continue to analyze carefully proposals for new games and game changes, implementing those we deem consistent with our statutory mission and with Governor Scott's policies in regard to gaming and gaming revenues.

As is referenced in your report, recent analyses of multi-state game sales by GTECH suggest that a decision to sell *Mega Millions* in Florida would have little or no benefit in terms of Educational Enhancement fund transfers. In addition, we worry that sales shifts to a second multi-state game could have seriously detrimental effects on



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Ms. Kathy McGuire
 Interim Director
 Office of Program Policy Analysis and Government Accountability
 February 25, 2011
 Page 2 of 4

FLORIDA LOTTO™ as a sustainable brand. Finally, it is worth noting that the next major development in the multi-state game realm is very much an open question at this point. It would appear unwise to move ahead with *Mega Millions* when another, more beneficial game might be on the horizon. Therefore, we see no compelling reason to join *Mega Millions* at this time but will continue to study the long-term impact of adding a second multi-state jackpot game.

The launch of fast-draw Keno in Florida would mark a major departure for our lottery. Any such decision should be preceded by comprehensive consideration not only of its potential revenue impacts, but its other implications as well.

Annually complete retailer recruitment cost benefit analyses and use these analyses to adjust recruitment efforts.

The department should complete its retailer recruitment cost-benefit analysis and evaluate the cost efficiency of recruitment activities, adjust these efforts as needed, and plan future activities.

Lottery Response: The Lottery concurs with this recommendation. The benchmark cost-benefit analysis has been completed, and, as a result, the Lottery has begun shifting resources away from less productive endeavors, for example, trade show participation, to more productive efforts, for example, sales outreach missions and delivery of formal presentations to corporate prospects. In addition, the analysis made clear that more work was needed in qualifying leads received through the Lottery’s website, and we are developing ways to improve the qualification screening process. It is our intention to continue this analytical approach on an on-going basis and adjust our recruitment methods throughout the year rather than just annually.

Complete [the department’s] examination of the retailer commission structure and report results to the Legislature

The department should complete its assessment of alternative retailer commission payment structures and include the cost and feasibility of various options such as prize cashing bonuses and incentives to reward retailers for performance that reflects the volume of tickets sold and prizes redeemed and their contribution to education. The Lottery should present its findings to the Legislature.

Lottery Response: The Lottery would be happy to discuss again with the Legislature its analysis of options for modifying the retailer compensation structure to maximize contributions to EETF. In fulfillment of Appropriations proviso language, the Department’s Retailer Compensation Study was completed and submitted to the Legislature a year ago. The study was provided to the appropriations committees of both houses in January 2010 and

Ms. Kathy McGuire
Interim Director
Office of Program Policy Analysis and Government Accountability
February 25, 2011
Page 3 of 4

was the subject of a presentation to a meeting of the House Committee on Government Operations Appropriations the following month. The study was a very substantial one, involving as it did consultations with 567 of our retailers, large and small, through interviews, focus groups and a survey. In addition, the study drew on analyses of data and experiences from a number of different sources. The study also closely adhered to the directions provided in the proviso for a benchmark study of retailer compensation, consideration of the impacts of inflation and exploration of a fixed-fee approach.

At the time of the study's completion, the Lottery expressed its intention to proceed with analyzing benefits and costs of options for improving the compensation structure. Work has continued in this regard, but not to a point at which changes are imminent. Our plan now is to renew our analysis and development of compensation options and to reach a decision by June 30 on changes to be made, if any, in our retailer commission, cashing bonus and sales incentive practices.

It must be said that our further work on this issue is unlikely to lead to the adoption of the "fixed fee" per-ticket concept OPPAGA has been advocating since its February 2007 analysis. (Lottery retailers currently are compensated on the basis set percentages of their sales and the prizes they redeem). OPPAGA asserts that, using a fixed-fee-per-ticket approach, the Lottery could reduce administrative costs, eliminate what it terms "disproportionate" compensation and guard against large increases in retailer commissions that could come with higher sales of higher-priced lottery tickets.

The Lottery respectfully but strongly disagrees with this proposal for many business reasons. Our discussions with retailers conducted during our study, standard practices in the retail industry and our own professional experience suggest that a switch to a fixed-fee structure would generate minimal cost savings, at best, while jeopardizing our relationship with our 13,200 retailers whose Lottery commissions already rank Florida in the bottom quartile of U.S. lotteries in terms of retailer compensation. Further, such a change would impede our efforts to expand our retailer network and, quite possibly, result in a major net loss of revenues through retailer defections and reduced cooperation.

The Lottery's retailer compensation structure should work to encourage the full cooperation of our retailers in our sales effort and to incentivize sales of the games that yield the highest dollar profits for the Educational Enhancement Trust Fund. This is exactly what is done when the Lottery pays a retailer \$1.00 for selling a \$20 Scratch-off Game ticket that produces \$3.20—the highest EETF return for any Scratch-off ticket. Retailer commissions in the lottery industry, as in any other retail industry, should be aimed at maximizing profits rather than ensuring that sales commissions are not "disproportionate" in some abstract sense to the amount of labor put into each sale. Under the fixed-fee logic, a grocer should get the same dollar profit from selling a pack of gum that it should for selling a package of filet mignons because it takes the same amount of work to scan the bar code on each.

Ms. Kathy McGuire
 Interim Director
 Office of Program Policy Analysis and Government Accountability
 February 25, 2011
 Page 4 of 4

Work with the Department of Management Services to reduce excess office space.

The Lottery should work with the Department of Management Services to monitor and evaluate the suitability of state-owned space as it becomes available.

The Florida Lottery concurs that its effective private lease rate exceeds the state’s established rate for office space owned by the Department of Management Services (DMS). The 2010 space study, conducted by an architectural and engineering firm in consultation with the DMS, found that the Florida Lottery does indeed lease 16,992 square feet of excess office space. Prior to the 2008 lease renegotiation, the department was informed by DMS that the state-owned facility pool was not able to provide the required contiguous office and warehouse space needed by the Lottery. The department then proceeded to have Cushman & Wakefield, a “tenant broker” designated by the State, complete an analysis of a proposed renegotiated lease renewal option compared both to prevailing private lease rates and to a build-to-suit option. The comparative analysis found that the current location remained the best value for the state since the relocation and the build-to-suit options were both cost prohibitive.

Nevertheless, this week I have approached Secretary Miles about our working together to take a fresh look at the Lottery’s building lease situation in the hopes of identifying effective next steps. We look forward to working with DMS and the Legislature to resolve this long-standing issue.

Thank you for your suggestions regarding potential gains in Lottery efficiency and revenues.

Sincerely,



Cynthia F. O’Connell
 Secretary

CFO/hk

cc: Dennis Harmon, Deputy Secretary
 Andy Mompeller, Inspector General
 Marcy Jackson, Chief Financial Officer
 Ken Hart, General Counsel