



February 2012

Report No. 12-05

Recovery Expected in Lottery Revenue; Options Remain to Enhance Transfers

at a glance

Although Lottery transfers to the Educational Enhancement Trust Fund declined by \$55 million in Fiscal Year 2010-11, revenues are projected to recover during the current fiscal year. To maintain and stimulate sales during 2011, the Lottery continued its practice of launching new products and enhanced product distribution.

To increase transfers to education, the Lottery should continue expanding its retailer network and enhancing its product distribution. 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, which may facilitate recruitment of large corporate accounts. Other options are to authorize Internet sales and video lottery terminals. However, these options represent expanded gambling and could 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 meet legislative performance standards. To reduce operating costs, it recently subleased some of its excess headquarters space to another agency. For additional efficiencies, it could consider using alternative retailer payment terms in its future contracts to attract and retain quality retailers while maximizing revenues to 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 enable the state's citizens to play state-operated lottery games.

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

The Lottery is headquartered in Tallahassee, with nine district offices that provide field support services to retailers and act as prize

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 efficiency and the Auditor General to conduct the financial audit.

redemption and sales centers.² The Lottery is self-supporting and receives no general revenue. For Fiscal Year 2011-12, the Legislature appropriated \$137 million from Lottery sales revenue and authorized 424 positions for Lottery operations.³ Prizes and retailer commissions are paid directly from sales revenues and do not appear in the department's appropriation. In Fiscal Year 2010-11, prizes were \$2.46 billion and retailer commissions were \$223 million.⁴

Since its inception, the Lottery has outsourced its core functions to produce, advertise, and sell tickets. In Fiscal Year 2011-12, the Lottery allocated approximately 68%, or \$93 million, of its \$137 million appropriation to produce and advertise draw 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 draw gaming system vendor, to provide computer systems, instant ticket vending machines, 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.

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 claimed at Lottery headquarters in Tallahassee.

³ The Governor vetoed \$569,000 for a compulsive gambling program.

⁴ 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.

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

Revenue Performance ---

In Fiscal Year 2010-11, the Lottery transferred \$1.192 billion to the Educational Enhancement Trust Fund, \$55 million less than the prior year. Although transfers declined slightly below the legislative standard of \$1.206 billion, the Lottery continued to meet its internal objective of transferring at least \$1 billion annually to the Educational Enhancement Trust Fund and exceeded the Revenue Estimating Conference forecast.⁵

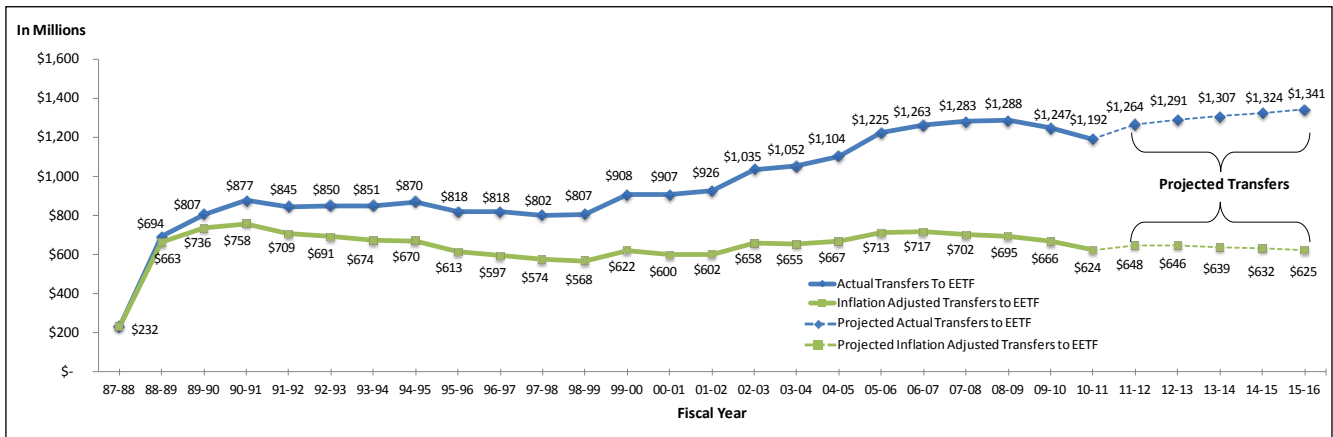
As shown in Exhibit 1, the Lottery's transfers to education have declined since Fiscal Year 2008-09. This is likely due to a variety of economic and demographic factors, including reduced population growth and the depressed economy, that limit consumers' discretionary spending on the Lottery's products. (See Appendix A for the Lottery's market share of disposable personal income over time and a comparison to other U.S. lotteries.) However, revenues are projected to recover during the current fiscal year. The November 2011 Revenue Estimating Conference projected that the Lottery's transfers to education will increase by \$73 million in Fiscal Year 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.

⁵ The Lottery's legislatively-approved performance standards are reported in its long-range program plan: *Long Range Program Plan Fiscal Years 2012-13 through 2016-17*, Florida Lottery, September 30, 2011.

Exhibit 1

Unadjusted Transfers to the Educational Enhancement Trust Fund (EETF) Declined \$55 Million (4%) in Fiscal Year 2010-11, but Are Projected to Increase by \$73 Million in Fiscal Year 2011-12¹



¹ Projected transfers from the November 2011 Revenue Estimating Conference were adjusted for inflation using the previous five-year average inflation rate of 1.1%.

Source: OPPAGA analysis of Lottery financial data, Revenue Estimating Conference, November 30, 2011, and U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index.

Revenue Enhancement Options—

The Lottery has taken steps in the past year to maintain and increase its sales and transfers to the Educational Enhancement Trust Fund. To further 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, 2012; however, some options would require additional time to implement, such as launching a keno game or installing video lottery terminals across the state.

The Lottery has continued to enhance its product mix and product distribution to stimulate sales

To increase revenues, the Lottery continued its practice of launching new games in 2011. For example, in March 2011, the Lottery launched the \$10 Lucky 7 Raffle, another in a series of raffle-styled games offered by the Lottery in the past several years. A limited number of tickets were available for sale within a two-month period, and in May 2011, the Lottery held a random computerized drawing from among the tickets issued. The Lottery estimated that the Lucky 7 Raffle earned a net \$2 million for transfer to the Educational Enhancement Trust Fund.

In July 2011, the department enhanced and relaunched its Monopoly family of scratch-off games. The relaunch brought back the \$10 price point and included a second chance game. The sales from the Monopoly games comprised 18% of the total instant ticket sales for Fiscal Year 2010-11.

In September 2011, the Lottery launched the \$20 Gold Rush Tripler scratch-off game, which generated over \$8 million in sales per week

during the first 12 weeks after its launch. This performance exceeds the highest average weekly sales among all U.S. lotteries that offered \$20 games in Fiscal Year 2009-10. The Gold Rush Tripler offers better odds of winning \$30 to \$500 compared to previous Gold Rush games, and the best odds ever offered for winning \$500,000 (1-in-1,512,000).

Enhanced distribution also benefitted revenues. The 2011 Legislature continued to provide budget authority for 1,500 instant ticket vending machines. The Lottery had previously installed 1,000 vending machines in 2009 and another 500 in 2010, mostly in existing lottery retailer locations.

During the first year of implementation, instant ticket vending machines were installed at the Lottery's highest selling retailers around the state. Scratch-off sales at these retailers increased 20% compared to a statewide decrease of 1% for all other retailers. Lottery officials attribute the higher sales levels as being primarily due to vending machine sales because the vending machines provide players convenient access to a larger selection of games. Assuming that 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.⁶ Moreover, the machines 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 could represent expanded gambling

Florida could consider adding several lottery games that might attract new players and substantially increase state revenues, although some of these games have drawbacks. For

⁶ 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 appears to account for the increase in sales at these retailer locations.

example, Florida could introduce fast keno, which could generate between \$49 million and \$258 million in additional transfers.^{7,8} Fourteen U.S. lotteries currently offer fast keno. (See Appendix D for U.S. lotteries that offer selected games and their sales methods.) To implement fast keno in Florida, the Legislature would need to grant budget authority for the Lottery to spend sales revenue to acquire a fast keno gaming system.⁹ If it were offered on video lottery terminals, fast keno could violate the terms of the gaming compact between the State of Florida and the Seminole Tribe of Florida.^{10,11}

Another game option, which is authorized by s. 24.105(18), *F.S.*, would be joining Mega Millions, which is another multi-state game that operates similar to Powerball. Multi-state lottery associations permitted states to cross-sell Powerball and Mega Millions starting in January 2010. All U.S. lotteries except California and Florida are selling both multi-state games.

Implementing Mega Millions could bring in additional revenues and help avoid losing sales

⁷ Fast keno is a draw lottery game in which players choose from 10 to 12 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 draw games, but occurs more frequently (typically every five minutes) and is often played in a social setting such as a bar or restaurant.

⁸ 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%.

⁹ Implementing fast keno also may require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that electronic drawings could occur every five minutes (s. 24.105(9)(d), *F.S.*).

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.

to bordering states. Georgia participates in Mega Millions and Florida participates in Powerball. Rather than potentially lose sales to Georgia, particularly when Mega Millions offers large jackpots, Florida could keep sales in-state by selling both games. Since Powerball drawings are held Wednesday and Saturday, and Mega Millions drawings are held Tuesday and Friday, cross-selling would provide players more choice of games offering large jackpots. However, preliminary sales data indicates implementing Mega Millions may also result in an offsetting sales shift from Florida Lotto and Powerball.

Introducing video lottery terminals statewide is another option that could be considered, but may violate the terms of the gaming compact.¹² If so, there could 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 such as video lottery terminals beyond what was legal at the time of the signing of the compact agreement, 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 even if revenue were lost from the gaming compact. (See Appendix E for more information.)

- **Bingo only.** The estimated net revenue impact would range from a loss of \$22 million to a gain of \$123 million.
- **Class II gaming, not limited to bingo.** The estimated net revenue impact would range from a gain of \$1 million to a gain of \$162 million.
- **Class III slot machines.** The estimated net revenue impact would range from a gain of \$76 million to a gain of \$291 million.^{13, 14}

¹² Eight states offered video lottery terminals in 2010-11. See Appendix D for U.S. lotteries that offer selected games and sales methods.

¹³ OPPAGA's video lottery terminal revenue estimate assumes 1,000

Adding new lottery games could 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 draw games.¹⁶ According to the department, the Florida Lottery is not authorized to use vending machines to dispense draw game tickets because the law was written before such technology existed and specifically restricts player-activated games.

As shown in Appendix D, at least 22 U.S. lotteries use full-service vending machines to sell both scratch-off and draw game tickets. Although the machines can be configured to accept credit and debit cards, U.S. lotteries

video lottery terminals are active a full year in 20 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 use full service vending machines include the District of Columbia, Maryland, Michigan, New York, Pennsylvania, and Rhode Island. See Appendix D for U.S. lotteries that offer selected games and sales methods.

configure the machines to accept only cash. Authorizing player-activated vending machines for draw games could facilitate the recruitment of large corporate accounts such as Walgreens and Walmart. This is because the machines minimize on-site labor and increase player choice and the potential for larger sales.¹⁷ In November 2011, the Revenue Estimating Conference estimated that placing full-service machines in existing and new retailer locations could generate \$21 million annually in additional transfers to education.

Another product distribution option is to authorize a new type of retailer or player-activated vending machine for electronic instant ticket games. These machines offer the players the option of touching a computer or video screen in order to view the instant ticket and reveal the outcome of the ticket or they can purchase a voucher and have the retailer reveal the outcome. Electronic instant vending machines could facilitate expansion into non-traditional retailer locations such as taverns and restaurants. These devices may 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. Other states permit subscription sales for certain draw games via the Internet.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. According to Lottery estimates, if Florida performed at average levels, annual sales through subscriptions could generate an additional \$10 million in transfers to education.

The U.S. Department of Justice released a legal opinion in December 2011 that found state lotteries' use of the Internet and out-of-state transaction processors to sell lottery tickets to adults within their states' borders does not violate federal law. However, 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.¹⁹

Authorizing the sale of lottery products over the Internet has the potential to affect revenues from the gaming compact depending on whether the Seminole Tribe of Florida 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 may no longer be required to make guaranteed minimum payments to the state. Instead, the tribe may 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 may not be affected.

Increasing the retailer network could increase the Lottery's sales

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

¹⁷ Currently, Walgreens and Walmart do not sell lottery products anywhere in the U.S., with the exception of the Florida Lottery pilot with the Walmart Neighborhood Market grocery stores.

¹⁸ Typically, subscription sales permit players to order a number of drawings at a time, such as 26 or more game drawings, and charge the purchase to a credit card through the lottery's website. See Appendix D for U.S. lotteries that offer selected games and sales methods.

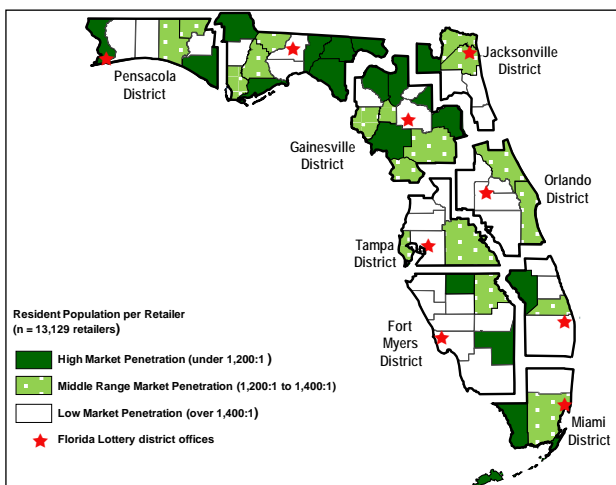
¹⁹ Section 24.105(9)(a)4, *F.S.*, restricts the use of player-activated machines and s. 24.118(1), *F.S.*, requires the purchase of no less than \$20 of other goods and services in order to use a credit card to purchase lottery products.

when they have more retailers per 10,000 residents.

In Fiscal Year 2009-10, the top 10 U.S. lotteries ranked by per capita sales had an average of 1,200 residents per retailer. During that period, Florida’s Lottery averaged 1,400 residents per retailer, and ranked 13th 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 13,100 to 15,500 retailers. Adding 2,400 new retailers has the potential to generate about \$44 million annually in additional transfers to the Educational Enhancement Trust Fund.²⁰

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. Almost half (31) 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 potential for expanding the department’s retailer network.

Exhibit 2
Retailer Market Penetration Varies Across the State



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

The Lottery’s retailer recruitment goal for Fiscal Year 2011-12 is to expand to 13,700 retailers. Some of the ways in which the department aims to achieve this goal are to continue its focus on potential corporate retailers and increase the use of instant ticket vending machines. It has also embarked on a pilot project with Walmart in which the retailer’s Neighborhood Market stores are selling lottery products in five metropolitan areas (Fort Myers, Miami, Orlando, Tampa, and West Palm Beach).²¹ In addition, the department is requesting authority to implement full-service vending machines. As discussed earlier, these machines may help in recruiting corporate accounts.

Operational Efficiency Options—

The Lottery continues to keep its expenses as a percentage of sales low. However, for additional efficiencies, it could consider using alternative retailer payment terms in its future contracts to attract and retain quality retailers while maximizing revenues to the state.

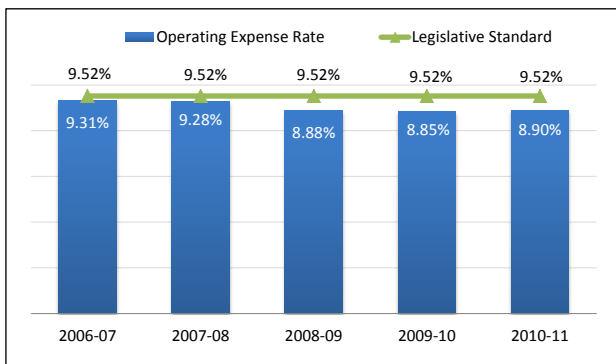
²⁰ OPPAGA’s estimate is based on new retailers achieving at least the average weekly gross sales for new retailers in 2011. The estimate assumes all 2,400 terminals being active for a full year and that 20% of their sales would be shifted from existing retailers.

²¹ Walmart Neighborhood Market stores sell the types of products typically purchased at grocery stores and pharmacies.

The Lottery’s operating expense rate is lower than the legislative standard

The Lottery’s operating expenses in relation to its ticket sales continue to be lower than the legislative standard, as shown in Exhibit 3. Compared to other U.S. lotteries, the Lottery had the 3rd lowest expense rate (8.8%) in Fiscal Year 2009-10, behind New Jersey (8.1%) and Massachusetts (7.8%).²²

**Exhibit 3
The Lottery’s Operating Expense Rate Has Continued to Meet the Legislative Standard**



Source: Department of the Lottery Long Range Program Plans.

The Lottery subleased some of its excess headquarters space and continues to seek additional building tenants

In prior reports, we noted that the Lottery has not been able to reduce its headquarters leased space commensurately with staffing reductions and was paying to lease about 30,600 square feet of excess office space at an annual cost of \$496,000. 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, which identified about 16,000 square feet of office space that would be suitable to sublease.

The Lottery consulted with the Department of Management Services to identify state agencies with expiring private leases, and contacted

prospective agencies. As a result of this effort, the Lottery executed a sublease for 14,854 square feet with the Office of Early Learning, which began to occupy the space in November 2011. The Office of Early Learning is subleasing space for employee offices and meeting, copy, and work areas. The two agencies are sharing reception, conference, mail, and warehouse space.

To prepare the space for occupancy, the Lottery reorganized its staff and spent tenant improvement funds for the construction needed to reconfigure space for both agencies. The Office of Early Learning will pay \$16.91 per square foot for the space it subleases, offsetting the Lottery’s headquarters lease costs by \$251,181 in Fiscal Year 2012-13.

In addition, the Lottery reports that having additional tenants in the building has made the cafeteria space (approximately 2,200 square feet) more attractive to restaurants, as it provides them with more potential customers. The department received proposals from three local restaurants interested in subleasing the cafeteria space. Lottery officials stated they have reached an agreement with one of the vendors and expect to open the cafeteria in early February 2012.

Retailer commissions could be modified to reduce costs

To increase sales and transfers to education, the Lottery began offering higher priced 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. While the Lottery’s administrative expense rate is low, the actual dollars spent on retailer scratch-off commissions has increased. Scratch-off sales commissions to retailers increased by 192% between Fiscal Years 2001-02 and 2010-11, while the number of scratch-off tickets sold increased by only 25%. During this same period, total retailer commissions increased significantly more (69%) compared to transfers to education (29%).

²² Florida Lottery’s ranking is based on the latest fiscal year data available from La Fleur’s 2011 World Lottery Almanac.

This is a result of commissions being tied to the dollar value of tickets sold rather than to the number of tickets sold. That is, retailers are paid a five-cent commission for each \$1 ticket and \$1 for each \$20 ticket they sell.

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 selling a jackpot or top-prize winning ticket, sales of a new lottery game during the early weeks of its launch or for achieving a pre-determined sales goal.

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 with incentive payments, staggered commission rates, and commission caps.^{23,24} For example, if the Lottery capped retailer sales commissions at \$1 per ticket sale and subsequently relaunched a \$30 scratch-off game, the Lottery could save about \$2 million in retailer sales commissions by saving \$.50 per ticket sale.²⁵

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

²³ *Lottery Scratch-Off Sales Increase; Options Available to Enhance Transfers to Education*, OPPAGA [Report No. 07-09](#), February 2007.

²⁴ In 2007, a similar structural inefficiency existed in the Lottery's scratch-off ticket vendor's payment terms. In October 2008, the Lottery negotiated new payment terms for its scratch-off games vendor contract to reduce Lottery's cost for higher priced scratch-off tickets.

²⁵ This estimate assumes the same sales volume (4,300,000) as the Lottery experienced selling \$30 scratch-off tickets in Fiscal Year 2008-09.

performance targets to attract and retain quality retailers. The Lottery published a study in January 2010 that identified eight alternatives for retailer compensation programs. (See Appendix F for more information.) The study included results from retailer surveys, interviews, and focus groups on their compensation preferences and compared Florida Lottery's retailer compensation against historical inflation rates and compensation rates of other U.S. lotteries. However, the Lottery's 2010 study did not include a cost and feasibility analysis for any of the retailer compensation alternatives. Instead, the Lottery reported that this analysis would be completed separately at a later date.

Lottery officials have recently released a draft cost analysis, but state that they do not plan to change the retailer compensation structure at this time. In December 2011, the Lottery released a draft report that quantifies the costs of the eight retailer compensation ideas it identified in 2010, as well as the cost of a ninth idea—raising the sales commission from 5% to 6% or higher.

Recommendations

In Fiscal Year 2010-11, the Lottery transferred \$1.192 billion to the Educational Enhancement Trust Fund, \$55 million less than in 2009-10. Sales are expected to recover by \$73 million in Fiscal Year 2011-12. 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 Options

We recommend that the Department of the Lottery consider the options listed below 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.

A second multi-state super jackpot game could also increase transfers to education, but more data on experience in other states is needed to estimate net sales revenue in Florida. The Lottery should carefully evaluate the benefits of offering fast keno and another multi-state game and provide the results to the Legislature.

- Consider using alternative retailer payment terms in its future contracts to attract and retain quality retailers while maximizing revenues to the state. Alternative payment terms could include fixed fees with incentive payments, staggered commission rates, and commission caps. For example, if the Lottery capped retailer sales commissions at \$1 per ticket sale and subsequently relaunched a \$30 scratch-off game, the Lottery could save about \$2 million in retailer sales commissions by saving \$.50 per ticket sale.

Legislative Options

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

- Consider authorizing new games. The Legislature could consider granting budget authority to the Lottery for a fast keno gaming system. The Legislature could also consider authorizing and granting budget authority to expand video lottery terminals statewide. 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 could violate the revenue sharing agreement with the Seminole Tribe of Florida.

- Authorize the Lottery to offer draw game and electronic instant ticket vending machines. The Legislature could consider authorizing the department to use vending machines to distribute draw products. Vending machines selling both scratch-off and draw 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 taverns and restaurants.
- Consider authorizing the Lottery to offer Internet sales. The Legislature could consider selling Lottery subscriptions and products over the Internet, but would need to address several issues, including the use of player activated terminals, restrictions regarding credit cards for lottery purchases, and the potential effect on the gaming compact 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 G.

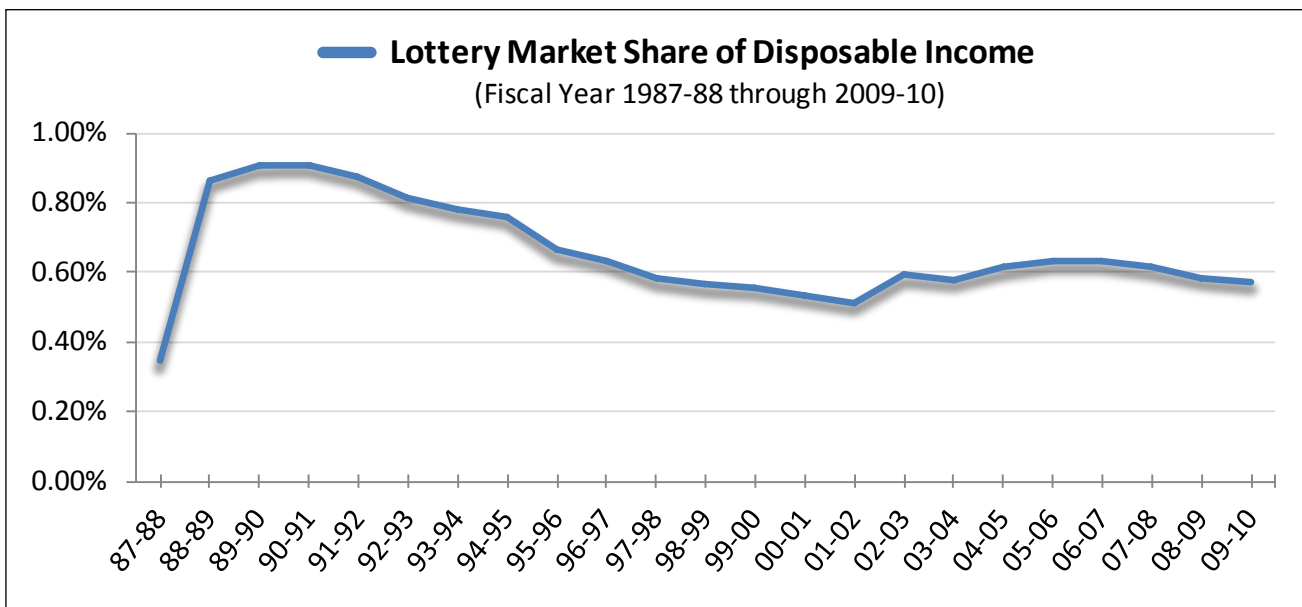
Appendix A

Lottery’s Market Share of Disposable Personal Income

Disposable personal income is the total personal income available to individuals for spending or saving after paying government taxes. For purposes of this report, the Lottery’s market share of disposable personal income is defined as per capita net sales (not adjusted for inflation) as a percentage of per capita disposable personal income (also not adjusted for inflation).

Table A-1 shows the Lottery’s market share of disposable personal income. 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. Table A-2 shows each U.S. lottery’s market share. In Fiscal Year 2009-10, the Lottery ranked 12th 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 Declining Slightly Since Fiscal Year 2007-08



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

Table A-2
Compared to Other U.S. Lotteries, Florida Lottery Ranked 12th in Per Capita Net Sales as a Percentage of Per Capita Disposable Income

U.S. Lottery ¹	2010 Population (in millions)	Ticket Sales (in millions)	Per Capita Sales	Per Capita Disposable Income	Market Share	Rank Order
Massachusetts	6.6	4,412.09	665	\$45,013	1.48%	1
Georgia	9.9	3,387.42	342	\$31,736	1.08%	2
New York	19.6	6,781.07	346	\$41,825	0.83%	3
Michigan	9.9	2,359.23	238	\$31,757	0.75%	4
South Carolina	4.6	1,007.16	219	\$29,948	0.73%	5
Maryland	5.7	1,706.57	297	\$43,498	0.68%	6
New Jersey	8.7	2,605.10	298	\$45,420	0.66%	7
Pennsylvania	12.6	3,065.72	243	\$36,531	0.66%	8
Ohio	11.5	2,490.19	216	\$32,832	0.66%	9
District of Columbia	0.6	230.16	377	\$62,110	0.61%	10
Connecticut	3.5	996.85	283	\$47,454	0.60%	11
Florida	18.7	3,900.50	209	\$35,296	0.59%	12
Rhode Island	1.1	234.62	222	\$38,216	0.58%	13
Kentucky	4.3	723.43	167	\$29,502	0.57%	14
Tennessee	6.3	1,060.11	167	\$32,717	0.51%	15
Maine	1.3	217.03	165	\$33,521	0.49%	16
Missouri	6.0	971.86	162	\$33,775	0.48%	17
North Carolina	9.5	1,421.33	150	\$31,821	0.47%	18
Virginia	8.0	1,435.13	180	\$39,476	0.46%	19
New Hampshire	1.3	233.77	177	\$39,945	0.44%	20
Illinois	12.9	2,191.42	169	\$37,997	0.45%	21
Arkansas	2.9	383.70	132	\$30,075	0.44%	22
Delaware	0.9	136.94	154	\$35,449	0.43%	23
Vermont	0.6	97.48	157	\$36,695	0.43%	24
Texas	25.2	3,738.37	148	\$34,826	0.43%	25
Indiana	6.4	740.34	115	\$30,961	0.37%	26
West Virginia	1.8	181.23	99	\$29,313	0.34%	27
Idaho	1.6	147.23	94	\$29,535	0.32%	28
Arizona	6.7	551.49	83	\$31,960	0.26%	29
Colorado	5.1	501.20	98	\$38,142	0.26%	30
Oregon	3.9	320.70	83	\$32,799	0.25%	31
Minnesota	5.3	498.96	94	\$38,383	0.25%	32
Wisconsin	5.7	481.10	85	\$34,455	0.25%	33
Iowa	3.0	256.26	85	\$34,817	0.24%	34

U.S. Lottery ¹	2010 Population (in millions)	Ticket Sales (in millions)	Per Capita Sales	Per Capita Disposable Income	Market Share	Rank Order
Louisiana	4.5	372.39	82	\$34,226	0.24%	35
Kansas	2.8	235.41	83	\$35,411	0.23%	36
New Mexico	2.0	143.59	71	\$30,698	0.23%	37
California	37.3	3,040.96	82	\$37,948	0.22%	38
Nebraska	1.8	130.58	72	\$36,329	0.20%	39
Washington	6.7	491.02	73	\$39,255	0.19%	40
Oklahoma	3.7	199.75	54	\$32,512	0.16%	41
South Dakota	0.8	45.54	56	\$36,948	0.15%	42
Montana	1.0	46.85	48	\$32,038	0.15%	43
North Dakota	0.7	24.42	37	\$39,300	0.10%	44

¹ Seven states do not operate a lottery (Alabama, Alaska, Hawaii, Mississippi, Nevada, Utah, and Wyoming).

Source: La Fleur's *2011 World Lottery Almanac* and the U.S. Department of Commerce, Bureau of Economic Analysis.

Appendix B

New Lottery Game Options

New games that attract new players have the potential to substantially increase revenues to education. While the Legislature could consider authorizing the Lottery to offer new games such as fast keno and video lottery terminals, these options could increase the negative social costs of gambling and, in some cases, could 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. 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 B-1
New Games Have the Potential to Increase Revenues to Education

Option	Advantages	Disadvantages
<p>Fast Keno Draw lottery game in which players choose from 10 to 12 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 million to \$258 million per year ▪ Can be limited to pari-mutuel facilities or social settings such as bars and restaurants 	<ul style="list-style-type: none"> ▪ Fast keno is reportedly more addictive than traditional lottery games, though not as addictive as video lotteries. ▪ Could be considered an expansion of gambling ▪ May require legislative action to modify the requirement for a drawing to be witnessed by an accountant, given that 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 ▪ If it were offered on video lottery terminals, fast keno could violate the terms of the gaming compact between the State of Florida and the Seminole Tribe of Florida.
<p>Daily Keno Draw 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 draw games and it may be played weekly or daily</p>	<ul style="list-style-type: none"> ▪ Potential recurring transfers to education range from \$6 million to \$12 million per year 	<ul style="list-style-type: none"> ▪ Could be considered an expansion of gambling
<p>Mega Millions Multi-state games, such as Mega Millions, often reach very large jackpot sizes because they cover several states</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

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 up to a gain of \$291 million per year depending on how it is implemented and after accounting for potential lost Seminole Tribe of Florida gaming revenue if determined to violate 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"> ▪ Potential recurring transfers to education could result in a loss of \$22 million per year depending on how it is implemented and after accounting for potential lost Seminole Tribe of Florida gaming revenue if determined to violate the terms of the revenue sharing agreement ▪ Because of its rapid play style, it may be more addictive than other lottery games, and thus increase social costs associated with problem and pathological gambling ▪ Could be considered an expansion of gambling ▪ Represents a substantial change for gambling in Florida by permitting casino-style lottery games statewide, which could be criticized by anti-gambling groups ▪ Would require legislative action to authorize player-activated video lottery 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
<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

Source: OPPAGA analysis of industry and Department of the Lottery information.

Appendix C

Product Distribution Options

Making lottery products more accessible and convenient for players by expanding product distribution has the potential to substantially increase revenues to education. New equipment such as full service vending machines, product distribution through the Internet, and increasing the number of retailers have the potential to increase revenues by making lottery products more readily available to residents and tourists. These options have been shown to drive lottery sales more than advertising or jackpot size. 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 point of sale to another.

Table C-1
Expanding Product Distribution Has the Potential to Increase Revenues to Education

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 tickets for draw games</p>	<ul style="list-style-type: none"> ▪ Potential to generate about \$21 million annually in additional transfers to the Educational Enhancement Trust Fund ▪ Provides more convenience to players who do not want to stand in line to purchase tickets ▪ Successful in other U.S. lotteries ▪ May attract large corporate retailers currently not selling lottery products ▪ Allows retailer network expansion into non-traditional retailer locations (e.g., airports and hotels) ▪ Would not require a modification to the Lottery retailer contracts that require retailers to carry both scratch-off and draw games 	<ul style="list-style-type: none"> ▪ Requires a statutory change to allow player-activated terminals for draw 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>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 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"> ▪ Could 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

Option	Advantages	Disadvantages
<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 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 much 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 10 U.S. lotteries. 	<ul style="list-style-type: none"> ▪ May require a statutory change to allow player-activated terminals (s. 24.105, <i>F.S.</i>) ▪ Use of credit cards for lottery purchases without a 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
<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 who don’t shop where products are currently being sold ▪ Adding 2,400 new retailers has the potential to generate about \$44 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>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.

Source: OPPAGA analysis of industry and Department of the Lottery information.

Appendix D

U.S. Lotteries Offer Various Games and Sales Methods

U.S. Lottery ¹	Daily Keno	Fast Keno	Video Lottery Terminals	Full-Service Vending Machines	Subscription Sales	Game Play via Internet
Arizona				X		
Arkansas				X		
California		X				
Colorado						
Connecticut						
Delaware			X			
District of Columbia		X		X		2
Florida						
Georgia		X				
Idaho				X		
Illinois				X	X	
Indiana	X					
Iowa						
Kansas		X				
Kentucky				X		
Louisiana						
Maine					X	
Maryland		X	X	X	X	
Massachusetts		X			X	
Michigan	X	X		X		
Minnesota				X	X	
Missouri		X				
Montana				X		
Nebraska						
New Hampshire				X	X	
New Jersey						
New Mexico				X		
New York	X	X	X	X	X	
North Carolina				X		
North Dakota					X	
Ohio	X	X		X		
Oklahoma				X		
Oregon		X	X	X		
Pennsylvania				X		
Puerto Rico						
Rhode Island		X	X	X		
South Carolina						
South Dakota			X			
Tennessee						
Texas				X		
U.S. Virgin Islands		X	X			
Vermont				X	X	
Virginia					X	
Washington	X			X		
West Virginia		X	X			
Wisconsin						
TOTAL	5	14	8	22	10	0

¹ Seven states do not operate a lottery (Alabama, Alaska, Hawaii, Mississippi, Nevada, Utah, and Wyoming).

² Washington D.C. has put the infrastructure in place to implement game play via the Internet, but its proposed i-Gaming site is not yet operational and it has been holding a series of community meetings to receive public input on this change.

Source: OPPAGA analysis of information from La Fleur's *2011 World Lottery Almanac*; other U.S. lottery websites; companies that provide lottery game and distribution options to other U.S. lotteries; and reviews of selected literature.

Appendix E

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 Ch. [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 could violate the terms of the gaming compact, thereby creating offsetting revenue losses that could 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, Seminole Tribe of Florida gaming payments may cease. As shown in Table E-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 potential lost revenue from the gaming compact.

Table E-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	\$204.1	\$349.0	\$226.7	\$387.8	\$302.3	\$517.1
Indian Gaming Revenues ³	226.0	226.0	226.0	226.0	226.0	226.0
Net Revenue	-\$21.9	\$123.0	\$0.7	\$161.8	\$76.3	\$291.1

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 pull-tabs, lotto, and other games similar to bingo, 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 assume 1,000 video lottery terminals are active a full year in 20 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 December 5, 2011, and adopted this estimate for Indian Gaming revenues in 2013-14. Source: Revenue Estimating Conference and OPPAGA analysis.

Appendix F

Options the Lottery Identified in Its Review of Retailer Compensation

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 eight alternatives for its retailer compensation structure. Table F-1 provides an overview of the alternative retailer compensation programs, ranked by the ratings of participants in retailer focus groups.

**Table F-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 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. 	Some Appeal

Compensation Program	Description of Option in Lottery's January 2010 Report	Ratings Given by Retailer Focus Group Participants
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 G

RICK SCOTT
Governor



CYNTHIA F. O'CONNELL
Secretary

FLORIDA LOTTERY

February 6, 2012

R. Philip Twogood
Coordinator
Office of Program Policy Analysis and
Government Accountability
111 West Madison Street
Tallahassee, Florida 32399-1475

Dear Mr. Twogood:

Thank you for the opportunity to respond formally to your office's report: "Recovery Expected in Lottery Revenue; Options Remain to Enhance Transfers." We, at the Lottery, have devoted considerable time and effort to providing the performance and efficiency data analyzed in this report and have given serious consideration to the recommendations it contains. I value the efforts your staff has put forward during the analysis of the Lottery's performance and their efforts in identifying how it might be improved.

Before responding to the report's specific suggestions, please know that we appreciate the report recognizing some of the Florida Lottery's recent efforts, such as continuing to enhance our product mix and distribution; maintaining the third lowest operational expense rate among U.S. lotteries; and reducing our lease costs by more than \$250,000 per year due to the subleasing of available space to the Office of Early Learning. These achievements, along with current Lottery sales trends, confirm our belief that we are on the right track.

Our response is organized around the "Department Options" appearing in the "Recommendations" section of the report on pages 9 and 10.

OPPAGA Recommendation: 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. A second multi-state super jackpot game could also increase transfers to education, but more data on experience in other states is needed to estimate the net revenue in Florida.

Lottery Response: In vigorously pursuing its mission of generating more funding for education, the Lottery continuously identifies, develops, tests, implements and markets game concepts having the potential to increase sales and transfers to the Educational Enhancement Trust Fund (EETF). These efforts are at the core of our business. As cited in your report, the success of the *Monopoly™* family of games, the \$20 *Gold Rush Tripler*, and the series of raffle games are but three examples of the results of such efforts.



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R. Philip Twogood
Coordinator
Office of Program Policy Analysis and Government Accountability
February 6, 2012
Page 2 of 5

As it has for a number of years, the report recommends that the Lottery consider offering the “other” multi-state super jackpot game - *Mega Millions*. While we agree that we need to always evaluate all other multi-state or even national game options, the Florida Lottery will not be recommending that *Mega Millions* be offered for the same reasons we have explained in previous responses to your annual analyses. A growing body of data from other lotteries indicates that adding *Mega Millions* to a portfolio that already contains *Powerball*® and a state lotto game provides little or no return because sales essentially shift from one game to another. As your report notes, “. . . preliminary sales data indicates implementing *Mega Millions* may also result in an offsetting sales shift from Florida Lotto and *Powerball*.” As you recall, after the successful launch of *Powerball*® in Florida, the Lottery did experience a decline in the sales generated from the Lotto product, but it has stabilized and is still a strong product. The additional erosion of *FLORIDA LOTTO*™ sales that could come with the introduction of *Mega Millions* would jeopardize *FLORIDA LOTTO*™ as a brand in Florida by making it financially impossible to offer the million-dollar prizes and the rollover patterns that have made it the nation’s leading state Lotto game.

Your report expresses concern about losing sales to Georgia which does offer *Mega Millions*. A look at the geography of Florida’s Lottery sales and the appeal of *Powerball*® will lessen this concern. Only 2% of Florida’s *Powerball*® sales come from the counties contiguous to our state borders with Georgia. In addition, during the three years since Florida joined *Powerball*®, *Mega Millions* jackpots have been higher than *Powerball*® jackpots only 37% of the time. With the recent revisions to the *Powerball*® game, the frequency of *Mega Millions* having higher jackpots than *Powerball*® is likely to decrease. Common sense suggests that few Floridians travel from central and south Florida to play *Mega Millions* instead of *Powerball*® on those relatively rare occasions when the *Mega Millions* jackpot is higher.

As the report recommended, Fast Keno is one of several game options the Lottery has been analyzing for some time. Offering the game in social establishments such as bars and taverns would further our strategy of growing our retailer base. In addition, the per capita sales results from other U.S. lotteries suggest that sales and EETF gains could be substantial in Florida. The Florida Lottery will continue to discuss this and other options with the Governor and Legislature in the coming months.

OPPAGA Recommendation: Consider using alternative retailer payment terms in [the Lottery’s] future contracts to attract and retain quality retailers while maximizing revenues to the state. Alternative payment terms could include fixed fees with incentive payments, staggered commission rates, and commission caps.

Lottery Response: The Lottery will continue its consideration of changes to its retailer compensation structure and report its findings and conclusions to the Governor and appropriate legislative committees next fall. This effort will build on the “Retailer Compensation Study” submitted to the Legislature in January 2010 and the follow-up feasibility analysis provided to OPPAGA in the course of the current study. Our work will be guided by the belief that a retailer compensation program must provide the foundation for maximizing the Lottery’s generation of education funding. To do so, such a program

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must motivate retailers to increase their lottery sales, be fair and consistent, build a sense of partnership with the Lottery, and encourage good customer service.

Having said this, we must point out—as we have since OPPAGA first raised this issue in its February 2007 report—that the Lottery fundamentally disagrees with OPPAGA’s assertions that Florida Lottery retailer compensation has grown “disproportionately.” We disagree with the idea that compensation should be premised on the number of tickets sold, which reflects some theoretical notion of the amount of effort the retailer puts into selling a ticket. We also disagree that retailer compensation should be capped. Instead, it is our belief that applying a set percentage commission to sales not only is proportionate and fair, but also motivates retailers to sell exactly the Lottery products that bring the highest yield for EETF.

Our belief is based on the following business facts and perspectives:

1. The Relationship among Sales Commissions, Ticket Prices and Education Funding Yield

There is a good business reason why the compensation structure used for the Lottery’s retailers differs from that used for other Lottery vendors. Retailers are on the front lines of lottery sales, meeting our customers/players face-to-face on our behalf. They are the ones on whom the Lottery must rely to sell and service our products in situations where customers are faced with a multitude of products competing for their discretionary dollars. Therefore, retailers are more appropriately considered agents rather than vendors and must be compensated in a way that motivates them to combine forces with the Lottery and carry our products, prominently display our games, educate our players, promote sales and provide good customer service.

As you can see from the table below, the EETF dollar yield for the higher-priced tickets is better than that for the lower-priced tickets, so it makes perfect sense for the Lottery to encourage its retailers to sell more higher-priced tickets. A commission structure proportionate to ticket price does exactly that.

Ticket Price	Current Commission	EETF Funding After commission	Additional EETF Funding per ticket
\$ 1	\$.05	\$.19	
\$ 20	\$ 1.00	\$ 3.80	\$ 3.61

The table shows that each time a retailer helps the Lottery sell a \$20 ticket rather than a \$1 ticket, EETF benefits from the extra \$3.61 of profit.

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In an example presented on page 9, the OPPAGA analysis suggests that capping the commission at \$1.00 on a \$30 Lottery ticket would have saved \$2 million in FY 2008-09 assuming that sales remained unchanged. The flaw in this argument is that sales would have not remained unchanged - the \$1.50 commission earned on a \$30 ticket sale motivated retailers to try and sell more of those tickets, and each \$30 ticket sold generated \$4.20 for the EETF.

2. "Disproportionate" Retailer Compensation

Over the years, OPPAGA has made a point of comparing the percentage rise in retailer compensation to the percentage rise in the number of tickets sold and in funding for EETF. Lost in this comparison is the fact that, under the current retailer compensation structure, the annual level of EETF funding from Scratch-off sales has been on average \$117 million higher, accumulating to over \$1.28 billion, than it was during the year preceding the Legislature's grant of variable prize payout authority.

3. Expanding the Retailer Network Versus Reducing Retailer Compensation

We believe there is a contradiction between the report's call for an expansion of the Lottery's retailer network on page 6 and its suggestions for modifying retailer commissions to reduce costs on page 8. It is not reasonable or realistic to think that potential retailers will be convinced to join the Lottery network while the Lottery restructures compensation to reduce costs. The Lottery cannot convince more retailers to carry a consumer product with less than a 5% profit margin that requires them to exert time and dedicate resources, including space, when they could carry other consumer products with 20-30% profit margins that require less financial resources.

4. Retailer Compensation: Florida versus Other Lotteries

The compensation paid to Florida Lottery retailers, as a percentage of sales, currently ranks it in the bottom quarter of the 44 U.S. lotteries. It also should be noted that no other U.S. lottery bases retailer compensation on the number of tickets sold.

5. Retailer Compensation: Florida Lottery versus Competing Consumer Products

The 2010 Lottery Compensation Study confirmed that at the retail location, the Lottery's 5% sales commission is competing with other discretionary spending opportunities. The Lottery products directly compete against soft drinks, candy, magazines and tobacco products, to name a few, which offer sales margins in the 20-30% range and sometimes pay for counter and floor space.

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6. Unintended Consequences


The Lottery's 2011 Retailer Compensation Feasibility Analysis found that the likely shift in ticket distribution from higher-priced to lower-priced tickets could actually decrease rather than increase EETF funding. For example, holding total sales unchanged, a 10% sales shift from higher price point tickets (\$5 to \$20) to lower price point tickets (\$1 to \$3) would result in a net reduction for EETF funding by \$15 million, even after the commission savings.

7. Value of Jackpot Bonuses

The report points out that the Lottery pays bonus commissions to retailers who sell large-prize-winning On-line tickets even though selling a winning ticket is a random occurrence which does not necessarily reflect a retailer's performance. While this is true as far as it goes, it fails to take into account the fact that a retailer knows the more tickets he sales, the greater are his chances of selling a winning ticket, and thus earning a bonus. Also, bonus commissions support a positive relationship between the Lottery and its retailers and provide retailers with a chance for a large cash payment.

Again, I would like to thank you for this opportunity to provide our perspective and response. We look forward to discussing these issues with the Governor, Legislature and you.

Sincerely,



Cynthia E. O'Connell
Secretary

cc: Dennis Harmon, Deputy Secretary
Bruce Hoffmann, Chief of Staff
Marcy Jackson, Chief Financial Officer
Glenda Thornton, General Counsel
Andy Mompeller, Inspector General

The Florida Legislature

Office of Program Policy Analysis and Government Accountability



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

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