



2012-2015



COMPREHENSIVE BUSINESS PLAN



AN AGENCY OF THE
STATE OF TEXAS

For Fiscal Years 2012 – 2015

TEXAS LOTTERY COMMISSION

Comprehensive Business Plan

Fiscal Years 2012-2015

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Foreword

This document, the Texas Lottery Commission Comprehensive Business Plan for fiscal years 2012-2015, was prepared by the management of the agency and reviewed by all divisions within the agency. This report has been prepared as a result of and in accordance with recommendations contained in the Sunset Advisory Commission Staff Report issued in August 2002 and restated in the Sunset Advisory Commission Staff Report issued in April 2004 (detailed below):

3.2 Require the agency to develop a comprehensive business plan.

The Lottery Commission's major initiatives should be guided by a comprehensive business plan to ensure their cost effectiveness. The business plan should include a specific description of each program, key management information, accurate financial data, and a detailed financial management plan. The Commission should review the business plan at least annually to assess the overall performance and value of each project. Projects that fail to meet financial objectives should be adjusted or terminated. This recommendation will build on recent efforts by the agency and ensure that business planning continues in the future.

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Executive Summary

The Texas Lottery Commission is unique among other Texas state agencies in that its ongoing operations combine for-profit performance expectations with the fiscal accountability and regulatory oversight of a government entity. Through its administration of Texas Lottery games, and the regulation and administration of all Texas charitable bingo-related activities, the Texas Lottery Commission has a profound fiscal impact in our state and in the lives of all Texans. Accordingly, the Commission is extremely respectful of its role and responsibilities as a careful steward of the resources entrusted to it, and understands that the inherent challenges involved in sustaining its success necessitate more comprehensive planning than the state's standard five-year strategic planning process provides. This document is designed to complement that process and, along with other planning documents and management tools, provide a map for the agency for the four-year horizon covering fiscal years (FY) 2012 through 2015.

The Texas Lottery Commission has two main functions:

- Under the State Lottery Act, the Commission is charged with administering and closely supervising all lottery games conducted in Texas to promote and ensure integrity, security, honesty, and fairness in the operation and administration of the lottery.
- Under the Bingo Enabling Act, the Commission is charged with administering and closely supervising all bingo conducted in Texas to ensure that bingo is fairly conducted and the proceeds derived from bingo are used for an authorized purpose.

Though all of the activities and functions of the Texas Lottery Commission are guided by the same vision and core values, there are significant differences between lottery and charitable bingo operations. Most importantly, the Texas Lottery is charged with generating revenue for the state of Texas by operating the lottery, including licensing retailers to sell lottery games, whereas with regard to charitable bingo, the Commission is charged with licensing and regulating an industry that generates revenues for nonprofit organizations in Texas. This is an important distinction and, accordingly, this document contains two separate business plans under one cover—one for the operation of the Texas Lottery and one for the administration and regulation of bingo through the Charitable Bingo Operations Division.

Texas Lottery – *Supporting Texas Education*

After nearly 20 years of operations, millions of players continue to enjoy the games of the Texas Lottery every day. In fact, the Texas Lottery is now the fourth largest lottery in North America. But the Texas Lottery is not just about fun and games. The most important function of the Texas Lottery is to generate revenue for the Foundation School Fund, which helps pay for public education in Texas.

The Texas Lottery supports Texas education. It's not just a slogan; since 1997, the vast majority of Texas Lottery proceeds – totaling more than \$13 billion – have been transferred to the Foundation School Fund.

In all, the Texas Lottery has generated more than \$19 billion for the state of Texas since the first ticket was sold in 1992.

Through FY 2011, the *Games of Texas* remain extremely popular with Texas Lottery players and the agency's annual transfers to the state of Texas have totaled \$1 billion or more for eight consecutive years. However, as a mature lottery, the agency must remain vigilant and responsive to industry trends and players' interests if it is to continue its high level of support for Texas education in the coming years. Concurrently, the agency is respectful of and sensitive to the viewpoints of the approximate one-third of Texans who are not in favor of gaming. Therefore, this document lays out initiatives carefully designed to ensure continued maximum revenue generation for the Foundation School Fund in FY 2012 through 2015, while being mindful of all viewpoints.

Charitable Bingo Operations Division – *The Most Charitable Game in Texas*

Charitable distributions derived from bingo activities in Texas benefit a broad spectrum of individuals and organizations—veterans' groups, volunteer fire departments, volunteer emergency medical services, libraries, boys and girls clubs, alcoholic recovery programs, community centers, animal adoption and rescue organizations, organizations providing recreation and sports activities for individuals confined to wheelchairs, museums, educational scholarships, and many others.

Since 1982, when the first licenses to conduct bingo were issued in Texas, through calendar year 2010, charitable bingo distributions exceeded \$971 million. Total prizes paid out to players in 2010 exceeded \$526.6 million—the highest in the history of charitable bingo in Texas.

Charity is an important component of our society. Providing authorized nonprofit organizations the opportunity to raise funds for their charitable purposes by conducting bingo improves the lives of many Texans. The Charitable Bingo Operations Division strives not only to provide charitable organizations the opportunity to raise funds for their charitable purposes but to ensure all proceeds derived from charitable bingo activities are used for lawful purposes, and to promote and maintain the integrity of the charitable bingo industry in Texas to ensure that bingo remains *The Most Charitable Game in Texas*.

Since 1992, the Texas Lottery has benefited Texans through the contribution of billions of dollars to the state of Texas and the Foundation School Fund. For more than 30 years, charitable bingo has benefited charitable organizations, players, and the citizens of Texas. Through close adherence to our vision, mission and core values, the Texas Lottery Commission is dedicated to ensuring that these benefits continue in the future.

Vision, Mission and Core Values

Agency Vision

To be the preeminent Lottery and Charitable Bingo agency through innovative leadership.

Agency Mission

Texas Lottery: The Texas Lottery is committed to generating revenue for the state of Texas through the responsible management and sale of entertaining lottery products. The Texas Lottery will incorporate the highest standards of security and integrity, set and achieve challenging goals, provide quality customer service and utilize a TEAM approach.

Charitable Bingo: Provide authorized organizations the opportunity to raise funds for their charitable purposes by conducting bingo. Determine that all charitable bingo funds are used for a lawful purpose. Promote and maintain the integrity of the charitable bingo industry throughout Texas.

Agency Core Values

Integrity and Responsibility - The Commission works hard to maintain the public trust by protecting and ensuring the security of our lottery games, systems, drawings and operational facilities. We value and require ethical behavior by our employees, licensees and vendors. We promote the integrity of charitable bingo in Texas for the benefit of charitable organizations.

Innovation - We strive to incorporate innovation into our products to provide the citizens of Texas with the best entertainment experience available through our products. We pursue the use of technology that enhances the services that we provide to our customers and reduces our operating expenses.

Fiscal Accountability - We emphasize fiscal accountability by ensuring that all expenditures directly or indirectly generate revenue, enhance security, fulfill regulatory requirements, improve customer service and/or boost productivity. We recognize our responsibility in generating revenue for the state of Texas without unduly influencing players to participate in our games. We maximize benefits to charities through the continual examination and review of charitable bingo operations.

Customer Responsiveness - The Commission takes pride in providing exemplary service to the people of Texas through the courteous dissemination of clear and accurate information about our products, services and regulatory functions. We seek and respond to feedback expressed by our employees, retailers, licensees and the playing and non-playing public. We apply this feedback in the development of our products and in the services that we provide.

Teamwork - We are committed to creating an environment of mutual respect where open, honest communication is our cornerstone. We embrace the diversity of our team and individual perspectives in working together to achieve our common goals.

Excellence - We strive for excellence by taking a position of leadership on issues that impact the Commission and achieve challenging goals by focusing on our core values.

Texas Lottery Business Plan

The Texas Lottery Today

Business Description and Historical Perspective

On August 26, 1991, House Bill (HB) 54, creating a lottery in Texas, was passed during a special session of the 72nd Legislature. On November 5 of that same year, House Joint Resolution (HJR) 8, containing the constitutional amendment to authorize a state lottery, was approved by Texas voters.

The Texas Lottery began generating revenue for the state of Texas in 1992, initially as a division within the Comptroller of Public Accounts. It became a separate, independent agency on September 1, 1993, through the authority of HB 1587 as passed by the 73rd Texas Legislature, Regular Session.

Key Service Populations

The agency serves a number of direct and indirect customers. The primary direct customers of the Texas Lottery Commission include lottery players and licensed retailers, the Texas Lottery Commissioners, and agency staff. Indirect customers are those Texans that benefit from the conduct of the *Games of Texas*, from the agency's net revenue contributions to the state of Texas, and from associated agency activities that serve the public good. In addition, the Texas Lottery Commission remains respectful of, and sensitive to, the viewpoints of Texans who are not in favor of gaming.

Direct Customers

Lottery Players

The Texas Lottery player base consists primarily of adult Texans 18 years and older, as well as similar-aged players from surrounding states and Mexico who travel to Texas to purchase Texas Lottery tickets.

Lottery Retailers

As of August 31, 2011, the Texas Lottery had 16,817 licensed retailers. The two largest groups, according to their Standard Industrial Code (SIC) classifications, are convenience stores (78.6 percent) and grocery stores (12.4 percent). The agency continues to streamline the licensing processes for retailers to make it easier for businesses to meet licensing requirements and to keep their records up to date. Examples include

options to submit license renewals and general information updates via the Internet and consolidating license expiration dates for multi-location retailers so that all licenses have a common renewal date. The agency has created retailer-focused, Web-based services to provide lottery financial and inventory data to retailers and continues to work with retailers and various other groups to standardize lottery financial statements.

Other Direct Customers

Additional direct customers of the agency include the three-member Texas Lottery Commission and agency staff. In addition, the agency serves as a resource to state leadership, other state agencies, and lawmakers regarding matters that would have an impact on the agency.

Indirect Customers

Texas Citizens

Texas citizens benefit from the creation of jobs resulting from the conduct of the *Games of Texas*. Texas families benefit from the Texas Lottery's net revenue contributions to the Foundation School Fund, which totaled more than \$13 billion as of October 2011 and from lottery prize money that is returned to the state from winners who are delinquent in child support payments, student loan payments, or other taxes or moneys owed to the state. In addition, from FY 1995 through October 2011, more than \$687 million in unclaimed Texas Lottery prize funds reverted to the state to be appropriated for health care and other programs authorized by the state legislature.

The Texas Legislature enacted legislation in 2009 requiring the agency to create and market a scratch-off game to benefit the Fund for Veterans' Assistance, which is managed by the Texas Veterans Commission. The agency now offers a veterans' scratch-off game on an ongoing basis in support of the fund. Since the introduction of the first game in FY 2010, these games have generated more than \$16.7 million in revenue through October 31, 2011.

Several Texas Lottery Commission initiatives indirectly support the welfare of Texans. The Texas Lottery continues its relationship with the Texas AMBER Alert Network, by communicating to the public through its lottery retailer network to help ensure that missing or abducted children are returned home safely. Since the Texas Lottery first joined the AMBER Alert Network in 2003, the agency has participated in 53 AMBER Alerts through August 31, 2011.

In September 2007, the agency joined the Texas Silver Alert System. The purpose of this network is to assist in finding persons over 65 years of age who have a diagnosed impaired mental condition. The agency has issued 227 Silver Alerts to the public through August 31, 2011.

The Blue Alert Program, designed to speed the apprehension of violent criminals who seriously wound local, state or federal law enforcement officers was added in August 2008. The agency has participated in three Blue Alerts through August 31, 2011.

The Texas Lottery's Enforcement Division and the Lottery Operations Security Department also aid law-enforcement officials in investigating and solving lottery-related crimes by providing detailed information on lottery transactions.

Management and Organizational Structure

The members of the original Implementation Task Force of the Texas Lottery were the architects of what has become known as the "Texas Model," a unique public-private arrangement. The agency maintains administrative, regulatory and management control over all critical functions, while utilizing private enterprises' inherent efficiency and profit motive to optimize the Texas Lottery's revenue potential. This organizational model maintains critical functions and broad oversight within the agency, while outsourcing those functions better performed by private industry. This approach shifts the burden of performance to the private sector while the state enforces performance standards under parameters strictly defined by contract. The agency also enjoys economies of scale by contracting with vendor partners to provide—directly or through subcontractors—a wide range of services statewide. This alliance with private enterprise enables the Texas Lottery to limit its work force to a fraction of the size of comparable states like California and Florida. Using this public-private concept, the agency addresses a number of significant business functions through contractual arrangements with seven primary vendors. Each vendor provides a variety of services under the continuous supervision of Commission personnel. This concept is illustrated on Chart B on page 10.

The three-member Texas Lottery Commission sets policy, promulgates rules for the agency, and performs all other duties required by law. The Governor appoints Commission members, with the advice and consent of the state Senate, to staggered six-year terms. One Commission member must have experience in the bingo industry.

The agency is comprised of 11 divisions: Administration, Charitable Bingo Operations (covered later in this document), Enforcement, Executive, Governmental Affairs, Human Resources, Internal Audit, Legal

Services, Lottery Operations, Media Relations and the Office of the Controller. An agency organizational chart (Chart A) is provided below.

Chart A
Texas Lottery Commission Org Chart

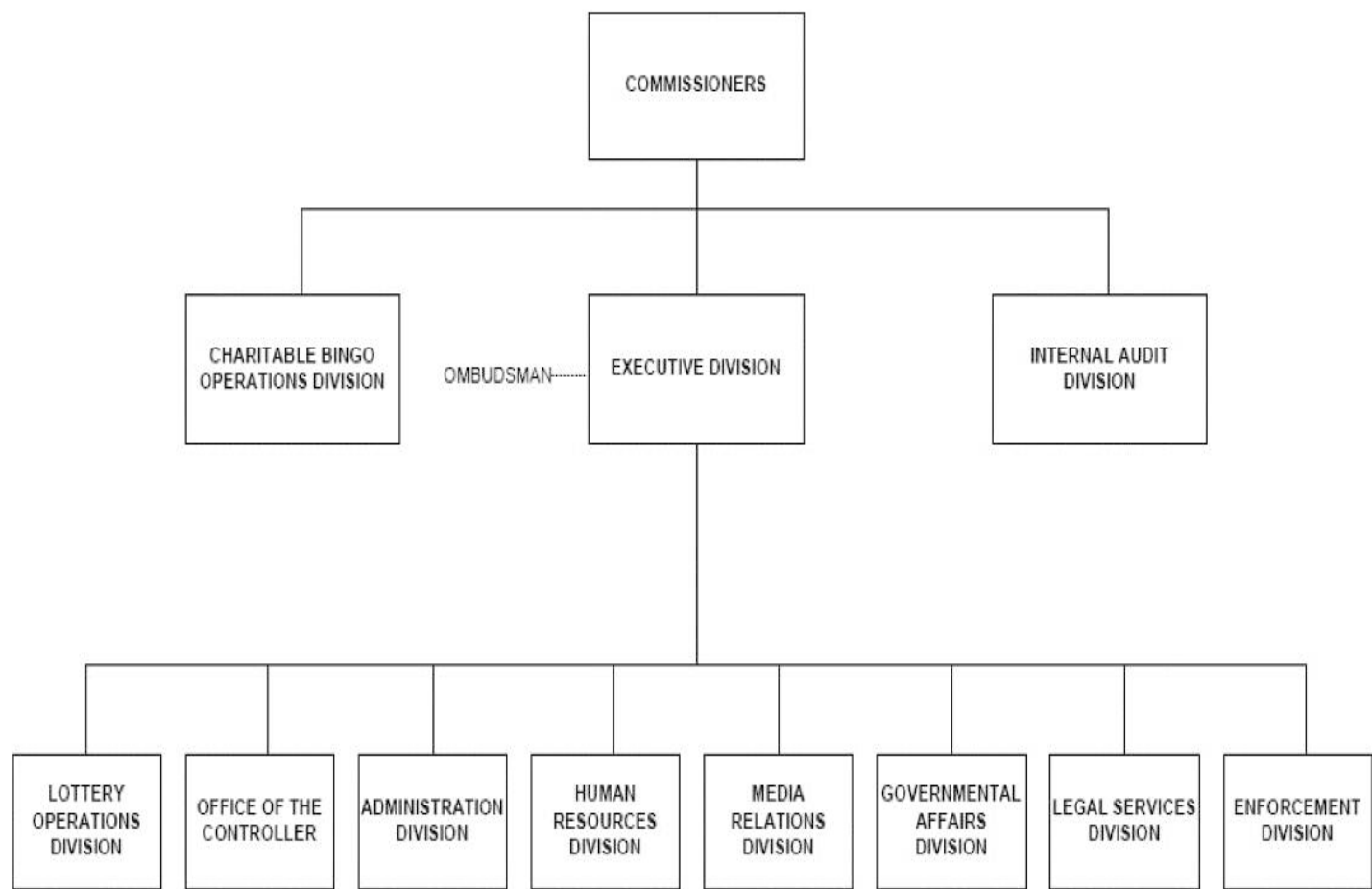
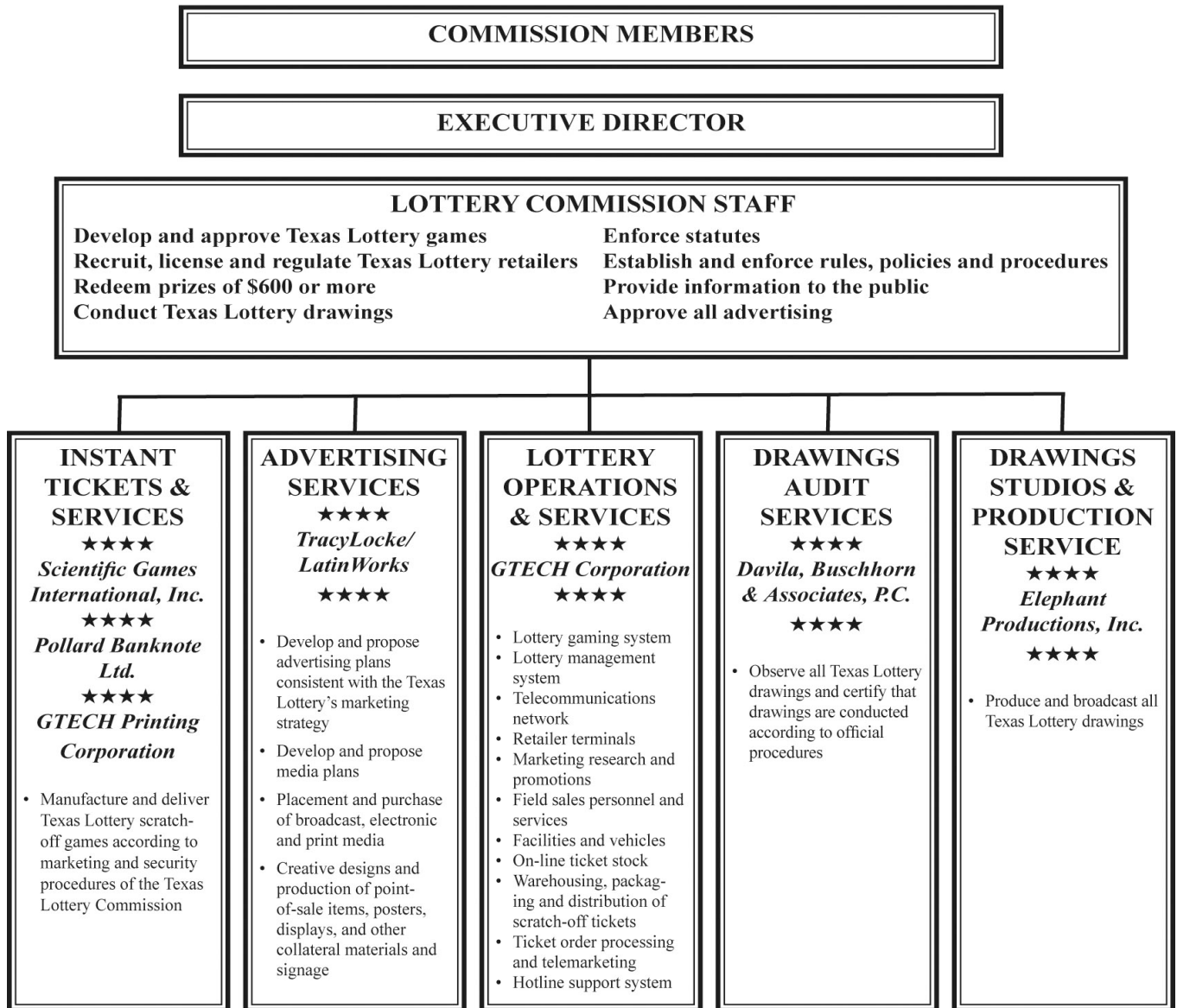


Chart B

OVERVIEW OF PUBLIC-PRIVATE “TEXAS MODEL” CONCEPT



Financial Overview and Assessment

Overview

The Texas Legislature establishes the Texas Lottery Commission's appropriations on a biennial basis. The agency's budget is prepared by the Office of the Controller with direct input from division management, reviewed by executive management and approved by the Commissioners. The budget serves as the foundation for the agency's financial planning and control.

For the 2012-2013 biennium, House Bill (HB) 1 established appropriations for the General Revenue Dedicated Lottery Account in the amount of \$172.9 million in FY 2012 and \$174.2 million in FY 2013 to operate the Texas Lottery. The funds have been allocated to strategies as shown in the following table:

**Texas Lottery Commission
Budget by Strategy (In Millions)**

Strategy	FY 2012		FY 2013	
	\$	%	\$	%
Lottery Operations	\$7.3	4.2%	\$7.4	4.2%
Lottery Field Operations	2.6	1.5%	2.6	1.5%
Marketing and Promotion	5.0	2.9%	5.0	2.9%
Security	4.5	2.6%	4.5	2.6%
Central Administration	13.3	7.7%	12.7	7.3%
Lottery Operator Contract	83.4	48.3%	83.9	48.2%
Instant Ticket Production Contract	18.0	10.4%	19.5	11.2%
Mass Media Advertising Contracts	32.0	18.5%	32.0	18.4%
Drawing and Broadcast Contract	1.5	0.8%	1.5	0.9%
Market Research Contract	0.9	0.5%	0.9	0.5%
Retailer Bonus	4.2	2.4%	4.2	2.4%
Total*	\$172.9	100%	\$174.2	100%

*Numbers may not sum due to rounding.

Sales

Sales for FY 2011 were just over \$3.81 billion, marking the highest level of total sales in the history of the Texas Lottery Commission, and 2012 is projected at \$3.75 billion. FY 2011 also marked the 8th consecutive year that the Texas Lottery generated more than \$1 billion in revenue. While proud of those results, the

agency recognizes these levels may not be sustainable and that future results may be flat or possibly decrease, in large part due to the maturity of the lottery in Texas and due to increased competition from other gaming activities, both legal and illegal, in Texas and in surrounding states. The Commission continues to attempt to increase playing interest through the introduction of new and innovative game concepts. Many of the initiatives being evaluated are detailed later in this document.

Administration Expense

The sale of lottery tickets is the revenue stream used to pay for all costs of Texas Lottery operations. This includes the payment of prizes for winning tickets, retailer commissions, and all other costs incurred in the operation and administration of the lottery. The State Lottery Act limits the combined total of retailer compensation and agency administration to no more than 12 percent of gross ticket revenues. Of this 12 percent, the State Lottery Act mandates that no less than 5 percent be allocated to retailers as commissions, with the remaining 7 percent of ticket sales allowed to be expended on administration of the Texas Lottery. The Commission returns any unspent administrative funds to the Foundation School Fund.

Planning for the Future

Product Mix

Background

There are 46 jurisdictions in the United States conducting government-run lotteries, including 43 states, plus the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. Some lotteries are structured as corporations, while the majority, including the Texas Lottery, are structured as traditional state agencies. The Texas Lottery is situated in a mature market where it competes primarily for the discretionary entertainment dollars of adult Texans age 18 and older. It is within this general environment that the Texas Lottery must tailor its products to appeal to its customers.

The Texas Lottery Commission strives to provide the citizens of Texas with the best entertainment experience available through its products. New games and game enhancements are continually being developed to keep Texas Lottery games innovative and exciting for Texas players. The agency uses market research to help ensure that any changes made to the current game mix will effectively meet the needs of Texas players, as well as serving the agency's mission of generating revenue to support public education.

Historically, the Texas Lottery has consistently ranked among the top selling lotteries in the United States, most recently ranking fourth and exceeded only by Massachusetts, New York and Florida.¹

The *Games of Texas* is the body of games that the Texas Lottery makes available to the playing public. These include instant games and on-line games². As of August 31, 2011, seven on-line games, four with add-on features, and approximately 85 instant games constituted the current game portfolio.

Instant Ticket Games

Background

Also referred to as “scratch-off” or “scratch” games, instant ticket games consist of preprinted tickets with symbols hidden under a latex covering. The player scratches off the latex and determines “instantly”

¹ *LaFleur's 2011 World Lottery Almanac*. 2011. 19th edition. Edited by Teresa La Fleur, Bruce La Fleur, Byron La Fleur, and Claire La Fleur. Rockville, Maryland: TLF Publications, Inc. P. 329.

² The industry term “on-line game” does not refer to an Internet-based game, but rather to the fact that the game tickets are generated from a terminal connected to a central system.

whether or not a prize may be claimed. Instant tickets include a variety of themes, play styles, and prize structures in order to offer an attractive game mix to each of the player segments. Popular game themes include gaming, money, numbers, seasonal, annuity and extended play.

Play styles include matching like dollar amounts or symbols, tic-tac-toe, key number or symbol matches, beat score, and add-up games. Additional play styles, such as “doubler” features, “automatic win” symbols and “win all” symbols provide added value to the games. Players enjoy multiple chances and multiple ways to win on each ticket.

Licensed property games also have helped serve a niche by capitalizing on well-known, branded concepts such as the *World Poker Tour*®, *Price Is Right*, *Monopoly*, the *Houston Texans* and the *Dallas Cowboys*. Licensed property games attract members of the public who might not typically purchase a lottery ticket, because of their familiarity with the branded property. The agency has also developed “core” or base games, those games that are always available for sale because of their long-term, ongoing popularity with players.

Prizes for current instant games range from \$1 to \$7.5 million. The majority of \$1 tickets typically offer a top prize of \$1,000 or less, while \$2, \$3, \$5, \$7, \$10, \$20 and \$50 games offer higher top prizes. The \$20 price point games offer top prizes of \$1 million to \$2.5 million, whereas the \$50 price point offers up to a \$7.5 million top prize. There also are games that provide annuity prizes that are paid out over a period of time. As of August 2011, annuity style instant games are offered at the \$2, \$5, \$10 and \$20 price points.

While on-line games have a set number of draws scheduled each week, instant ticket games offer the possibility of immediate winning experiences with cash and non-cash prizes. Most instant ticket purchases are impulse buys. Therefore, it is important to create games that are attractive to players, provide frequent opportunities to win, and offer a variety of prizes per game. In evaluating industry best practices related to scratch-off game marketing initiatives, the Texas Lottery has added “call-outs” to faces of certain tickets. These “call-outs” communicate to consumers specific prize amounts and/or the number of prizes in a game.

Challenges and Opportunities

While the Texas Lottery has experienced tremendous success with its instant product category, the agency has potentially reached the maximum benefit that can be gleaned from a frequent instant game launch strategy. Printed instant products have been available in the industry for decades and there has been limited vendor innovation with regard to the style and features of instant products over time. The Texas Lottery’s efforts to keep instant products fresh and interesting for the consumer must now focus on unique opportunities to tweak existing game designs, while developing new and innovative product positioning and marketing strategies around this product category. These efforts are critical in order to reach new players,

maintain player interest and ensure existing sales and revenue levels for this product category.

Key Initiatives

In order to be responsive to the changing tastes and preferences of consumers, the Texas Lottery must actively explore new instant game opportunities and unique product enhancements that hold the most promise for generating incremental revenue for the Foundation School Fund.

Spotlight Game Offerings

In FY 2009, the agency introduced a \$20 “Spotlight” or “Mega” instant game, *\$500,000,000 Blockbuster*. A Spotlight or Mega game is known in the industry as a game that typically has a larger than normal print-run with an increased prize payout. \$20 games in Texas were typically produced at a 3 million print quantity and a 72-percent payout. Utilizing industry best practices, *\$500,000,000 Blockbuster* was produced with a 33 million print-run and a slightly elevated prize payout percentage. The larger print quantity and increased payout allowed for the creation of many “call-out” features on the front of the ticket that were appealing to players such as:

“More than \$500,000,000 in prizes”

“Win up to \$2.5 million instantly”

“More than 75 percent payout”

“50 cash prizes from \$1 million to \$2.5 million”

In order to communicate this important game information to the public, the Spotlight game featured a dedicated advertising campaign to support the launch in market. *\$500,000,000 Blockbuster* launched with a five-week advertising campaign that was coupled with a full suite of retailer point-of-sale pieces. This game has been very successful for the agency in terms of sales and revenue generation, resulting in sales of \$420,597,540 and revenue of \$61,605,387 during the first full year of sales. Capitalizing on the success of *\$500,000,000 Blockbuster*, the agency introduced *\$500 Million Frenzy* in March 2011. This game was also well received by retailers and consumers, similar to its predecessor.

Based on the success of the Spotlight game concept, the Texas Lottery is currently evaluating Spotlight game offerings at other price points in the instant product category. New offerings will be issued at the \$10 and \$20 price points during FY 2012, and other price point offerings will be evaluated for introduction in the future.

Market Testing of Modified Prize Structures and Increased Print Quantities

Similar to the Spotlight game concept, the Texas Lottery is researching the use of larger print quantities with certain games that allow for either larger top prizes and/or increased number of mid-level and top prizes. The Texas Lottery is utilizing in-market testing to evaluate consumer responsiveness to these new game structures.

Consolidation of Price Points

The Texas Lottery has a broad diversity of price points from \$1 to \$50. This includes price points with typical monetary denominations (\$1, \$5, \$10, \$20 and \$50), but it also includes non-typical denominations (\$2, \$3 and \$7). The Texas Lottery periodically evaluates these non-typical denominations to determine their continued interest from consumers. The agency has discontinued its \$25 and \$30 price point offerings based on these reviews, and the \$7 price point is currently being evaluated for discontinuation. This price point has served as a niche game offering associated with a 7's themed play style, but the performance of the \$7 price point has not kept pace with offerings at the \$5 price point. The agency is exploring expanded offerings at both the \$5 and \$10 price points associated with the possible discontinuation of the \$7 price point.

Growth of Core Instant Product Offerings

Core (or base) games are games that are always available for sale because of their long term, ongoing popularity with players. Core games are important within the Texas Lottery's portfolio as anchors at various price points, mitigating the need to identify and produce additional offerings at a particular price point. Examples of current core games are \$1 *Find the 9's*, \$2 *Weekly Grand*, \$2 *Break the Bank*, \$2 *Bingo*, \$3 *Cashword*, \$5 *Monthly Bonus* and \$10 *Set For Life*. The Texas Lottery strives to identify unique products that both resonate with players and offer the potential to become core offerings. The agency recently has had tremendous success with its uniquely designed and positioned *Texas Lottery® Black* product offered at the \$10 price point. This game shows significant potential as a core offering. The Texas Lottery will continue to identify and bring to market products that it believes can achieve this level of player loyalty.

Products Geared to Appeal to New Players

As a mature, 19-year old lottery, the Texas Lottery recognizes that in order to remain relevant and continue to grow as a revenue generating entity, it must attract new players. The Texas Lottery must also achieve this goal within the framework of its traditional lottery (instant and on-line) game offerings.

The *Texas Lottery® Black* game is an example of a traditional lottery game that the agency was able to position uniquely with potential consumers. The *Black* ticket concept was different for the Texas Lottery in terms of its look and feel. Past games had always used brightly colored, attention-getting tickets to attract consumers. This ticket was designed to be visually striking with its black-on-black design and gold

lettering, allowing it to stand out in the crowded retail market place. In order to position the new game as a trendy, premium, ‘must-have’ game, *Texas Lottery® Black* required specially crafted marketing and advertising support. In coordination with the agency’s advertising vendors, the game launched with an integrated multi-media advertising campaign utilizing radio promotions, magazine and newspaper, out-of-home, including outdoor billboards, and point-of-sale materials, positioning the product in sleek, unexpected placements and executions.

The agency will continue to explore similar new product initiatives that have the potential to reach a new group of players.

Licensed/Branded Property Products

As noted above, the Texas Lottery must create products that will engage new consumers. Well-recognized brands and licensed properties that have strong consumer affinity can be leveraged to appeal to consumers that may have lapsed in their lottery participation or that have not considered lottery product trial in the past. The Texas Lottery considers these offerings to be an important part of its product portfolio and works to identify brands that would be well received by consumers.

Luck Zone Player Internet Site

Product innovation is not always limited to the attributes and qualities of the product itself. Innovation can occur in extensions of the product such as offering promotional second chance drawings for merchandise and experiential prizes. The Texas Lottery has offered a number of games over the years that include this unique merchandise/experiential prize feature that appeals to a particular player segment.

The Texas Lottery closely monitors both consumer trends and developments within the lottery industry. Numerous lottery jurisdictions operate Internet-based players clubs that offer promotional second-chance drawing features and an array of other player services.

In the past, the Texas Lottery has offered its second-chance drawings via mail-in entry. However, the Texas Lottery recognizes that technology has changed the way that consumers desire to interact with organizations. The agency has recently launched two games, *Dallas Cowboys* and *Houston Texans*, which feature Internet-entry second-chance drawings where non-winning tickets are entered via the Luck Zone player site. This player convenience has been well received and resulted in increased entries in these drawings. The Texas Lottery will monitor the ongoing success of the Luck Zone with an eye toward expanded player services over time.

Market Testing of Unique Production Features for Instant Games

While many of the game design changes made by instant ticket manufacturers have been subtle and not resulted in major changes to the product category, instant ticket manufacturers continue to develop new production methods that can be marketed to consumers. One example that the agency has leveraged successfully is a production method where the latex overprint on the ticket is scented and emits a fragrance (e.g., peppermint or chocolate) when scratched. This scent can be combined with the theme of the game to make the product uniquely appealing for the player.

Another recently introduced production method permits play areas to appear on the front and back of the ticket. This option offers players more play action without the need to increase the physical size of the ticket. The agency will continue to evaluate this and other added-value features for use in Texas that may increase player enthusiasm for games and therefore increase game sales and revenue.

National Instant Game

State lotteries do not compete head-to-head for lottery business, presenting a unique opportunity for industry cooperation to develop and bring the best games to market. Led by the efforts of state lottery directors in the *Mega Millions*[®] consortium and Multi-State Lottery Association (MUSL), an agreement was reached between the groups allowing for cross-selling of both multi-jurisdictional jackpot games (*Mega Millions* and *Powerball*[®]). This effort has led to a new level of cooperation between U.S. lottery organizations to design and bring new products to market that will appeal to lottery consumers. A group of lottery directors, along with representatives of the lottery vendor community, are currently in discussions on the design and development of a hybrid instant ticket/draw game that would be offered across lottery jurisdictions. This game would have benefits and features that come with significantly larger production runs and the leveraged resources of the participating organizations. The concept, still in the formative stages, includes innovative new scratch ticket art schemes, a coordinated national marketing campaign, some components of existing draw games, and, while not “selling” tickets on the Internet, using the Internet to “connect” players via social media (e.g., Facebook and Twitter). The Texas Lottery is participating in these discussions and will bring this game to market if it is deemed to be beneficial to the mission of the agency.

On-line Ticket Games

Background

The terminals in the retailer locations are said to be “on-line” with the lottery operator’s central computer system in Austin. The Texas Lottery conducts drawings independent of the lottery operator’s central

computer system to determine a set of winning numbers for these types of games.

Most on-line games require the player to select from a pool of numbers. For example, when the pool consists of 37 numbers and a player selects five numbers from the pool, the game is described as having a 5-of-37 matrix in this example. In order to claim the top prize, the player's ticket must correctly match all five numbers drawn. Other prizes may be paid for matching fewer than all of the numbers selected. Players may select their own numbers or have them selected by the on-line terminal by choosing the Quick Pick option.

The Texas Lottery's current on-line game offerings include *Powerball* with the add-on feature *Power Play*[®], *Mega Millions* with the add-on feature *Megaplier*[®], *Lotto Texas*[®], *Pick 3*[™] with the add-on feature *Sum It Up*[®], *Daily 4*[™] with the add-on feature *Sum It Up*, *Cash Five*[®], and *Texas Two Step*[®].

Lotto Texas, *Powerball* and *Mega Millions* are multimillion-dollar rolling jackpot-style games. *Lotto Texas* was the first on-line game introduced in Texas, in November 1992. The game has undergone three game or matrix changes since its introduction. The starting jackpot for *Lotto Texas* is currently \$4 million and the numbers are drawn twice per week. In October 2003, Texas joined the multistate game *Mega Millions* and sales began on December 3, 2003. The *Mega Millions* game matrix changed in the summer of 2005 as a result of the California Lottery joining the game. Currently, the *Mega Millions* starting jackpot is \$12 million and numbers are drawn twice per week. For an extra \$1 wager, the *Megaplier* feature allows players the chance to increase their non-grand/jackpot prize winnings. In January 2011, the *Megaplier* feature was enhanced to offer a guaranteed second-tier prize amount of \$1 million to ensure comparability with the *Power Play* feature.

Until January 2010, *Mega Millions* was comprised of Texas and 11 other member states including California, Georgia, Illinois, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Virginia and Washington. In October 2009, an historic cross-selling agreement was reached between *Mega Millions* member states and the Multi-State Lottery Association (MUSL), which operates *Powerball*, to allow *Mega Millions* states to sell *Powerball*, and *Powerball* states to sell *Mega Millions*. January 31, 2010, marked the first date that member states could begin offering both games. The Texas Lottery Commission adopted the *Powerball* game rule at the January 6, 2010, Commission meeting, allowing the executive director to sign the necessary agreements for Texas to begin selling *Powerball*. Sales of *Powerball* began in Texas on January 31, 2010. Offering both multi-state jackpot games with large population bases creates the opportunity for increased jackpot rolls and record-breaking jackpot levels. Offering both of these games has resulted in increased revenue to the Foundation School Fund.

Currently, the *Powerball* starting jackpots are \$20 million and numbers are drawn twice per week. Like *Mega Millions*, *Powerball* also has a multiplier feature, called *Power Play*. For an extra \$1 per play, players can

increase their non-grand/jackpot prizes by two, three, four or five times. The Match 5 prize (2nd-tier prize) automatically wins a \$1 million prize with *Power Play*.

Pick 3 is a daily non-jackpot game that has typically realized consistent year-over-year sales growth since its inception in October 1993. The game experienced its first sales decrease in FY 2008, due to the addition of the *Daily 4* game. Even with this anticipated cannibalization caused by *Daily 4*, the *Pick 3* game continues to be the agency's best-selling on-line game, illustrating that non-jackpot style games can be effective in reaching sales and revenue goals. The only changes made to *Pick 3* in its 16-year existence have been the addition of day drawings in April 2002 and the addition of the *Sum It Up* feature in November 2007. *Sum It Up* is an add-on game concept first introduced on the *Daily 4* game and then added to *Pick 3*. For an additional wager, players can win if the sum of their three numbers matches the sum of the three numbers drawn in the applicable drawing. This provides players a chance to win even if they don't win on the base game. *Pick 3* drawings are held twice daily six days a week.

Cash Five is a roll-down style game that began in October 1995 and remained unchanged until July 2002. In the *Cash Five* game, when there is not a top-prize ticket sold for a drawing, the prize funds allocated to the top-prize tier "roll-down" to the second-prize tier and that prize amount increases accordingly. A matrix change in 2002 improved the overall odds of winning from 1 in 100 to 1 in 8, changing the game from one of the most difficult five-digit games to win in the country to one of the easiest. *Cash Five* is drawn six days a week.

Texas Two Step is a rolling jackpot-style game similar to *Lotto Texas*, but on a smaller scale, with jackpots starting at \$200,000. *Texas Two Step* began in May 2001 and was originally drawn twice per week, on Tuesdays and Fridays. However, after Texas joined *Mega Millions*, *Texas Two Step* draw days were changed to Mondays and Thursdays to avoid direct competition with *Mega Millions*, which had the same Tuesday/Friday draw schedule. *Texas Two Step* has a loyal player base and experiences consistent sales at lower-level jackpots. However, it does respond like any other jackpot game in that, as the jackpot climbs, sales increase.

Daily 4 is similar in play style to *Pick 3*. However, it also offers an additional play style, Pair Play, which allows players to wager on the first two, middle two or last two numbers drawn. Pair Play is not currently offered on *Pick 3* and this assists in differentiating the *Daily 4* and *Pick 3* games. The *Sum It Up* add-on game feature is also available on *Daily 4*. If the sum of the player's numbers matches the sum of the four numbers drawn, the player wins *Sum It Up*. This provides players a chance to win even if they don't win on the base game. In an additional attempt to differentiate *Daily 4* from *Pick 3*, *Sum It Up* was only available on the *Daily 4* game during its launch. *Sum It Up* was later added to the *Pick 3* game. *Daily 4* follows the same drawing schedule as *Pick 3* and is drawn twice daily six days a week.

Challenges and Opportunities

One of the most significant differences between the instant and on-line game playing experience is the time that elapses between buying the ticket and the player finding out if the ticket is a winner. For example, a player who purchases a ticket for the *Lotto Texas* on-line game on a Sunday morning must wait until the *Lotto Texas* drawing occurs on Wednesday night to determine if a prize has been won. In contrast, as soon as an instant ticket is scratched, the player immediately knows if the ticket is a winner. Most prizes can be paid immediately at a retail location, creating an opportunity for a subsequent ticket purchase.

On-line games, industry wide, have relied primarily on jackpot levels to drive sales and revenue generation. Lotteries nationwide are attempting to increase on-line game sales by exploring the introduction of higher price points. However, lotteries have struggled in these efforts, as players have become accustomed to playing for multi-million dollar jackpots for a \$1 wager. This has limited the industry's ability to create the value proposition differential between price points that has been so successful with the instant ticket product category.

As noted above, lotteries nationally have recently collaborated to expand the offering of multi-jurisdictional jackpot games (*Mega Millions* and *Powerball*) across significantly larger population bases. This expansion of the on-line jackpot game offerings in Texas requires the continued monitoring of jackpot and daily (non-jackpot) game performance for possible modifications and adjustments to the overall on-line game portfolio.

Multi-state games like *Mega Millions* and *Powerball* are capable of generating jackpots upwards of \$300 million, creating excitement for players and retailers alike, and also driving sales. While the agency enjoys the benefits of these large jackpots and the strong sales associated with them, they can create a phenomenon known in the lottery industry as "jackpot fatigue." This phenomenon causes players to become desensitized to smaller jackpot amounts, and ever-larger jackpots are required to garner the attention and excitement of players. The lottery industry, including Texas, has relied on the jackpot-style games to reach large jackpot amounts in an effort to increase sales. However, due to jackpot fatigue, sales and revenue for this type of on-line game have generally decreased over time.

New on-line games and/or game changes require execution of the agency's formal administrative rulemaking process and extensive system software development before introduction. Additionally, on-line games typically require costly advertising expenditures to communicate to the public about the new product or changes to an existing product. These games differ from instant tickets, as the instant game serves as its own communication vehicle due to its visible placement at retail. These on-line product requirements serve to limit the agency's ability to conduct frequent introductions of new on-line games or make rapid changes to existing games.

Lastly, there are a number of additional on-line games offered in other lottery jurisdictions that are not being pursued in Texas as they would require specific legislation. Keno, which is traditionally sold in bars and restaurants, and on-line terminal-based raffle games are examples of such initiatives. During the 82nd Legislative Session, several bills were filed that would have expanded the types of games offered or regulated by the Texas Lottery Commission. These included video lottery terminals at certain locations, poker gaming, and various types of casino gaming. None of these bills was enacted.

Key Initiatives

Price Point Expansion

While challenging, it is important to continue efforts to move to expand the price point offerings for online game products. Price point expansion in the instant product category was a key driver in growing instant ticket product sales and revenue over a period of many years in Texas.

The industry has worked collaboratively in this effort to redesign the *Powerball* game and reposition it at a \$2 price point. This change will be implemented in January 2012. The new game will feature significantly higher starting jackpots than any other jackpot game available in the industry. Additionally, the game will feature a significantly larger second-tier prize of \$1 million, improved jackpot odds and better overall game odds. This product launch will serve as an important in-market test of the industry's ability to move consumers to a higher price point for the on-line product category through the creation of an added-value proposition.

The Texas Lottery also has recently conducted research on new on-line game concepts that would also be positioned at the \$2 price point. These daily game concepts feature new and unique play styles, elevated prize payout percentages and significantly improved overall odds of winning when compared to existing on-line games. The top research concept is currently being evaluated for potential sales and revenue impact on the existing on-line game portfolio and the agency will determine whether to proceed with introduction based on this analysis.

Evaluation of Jackpot Game Portfolio

With the introduction of the new \$2 *Powerball* game in January 2012, the Texas Lottery will need to closely monitor sales performance among all of its jackpot games. *Lotto Texas* sales will be evaluated in particular, as its drawings occur on the same nights as the *Powerball* game.

Lotto Texas Add-on Feature

Add-on features, such as *Megaplier* and *Power Play*, have experienced successful sales and revenue

performance with other jackpot games in Texas. The Texas Lottery is currently exploring add-on game features for the *Lotto Texas* game. These concepts will be researched and evaluated for revenue potential and the Texas Lottery will determine whether to proceed in launching one of these add-ons.

On-line Game Cross Promotion

The Texas Lottery has been very successful in designing instant games that feature or highlight games from its on-line portfolio. A prize in these instant games is a free play in the associated on-line game. These games have performed well from a sales perspective and introduced instant game players to the Texas Lottery's on-line product offerings. The agency will continue to introduce these games.

Distribution Channels

Background

Entertaining and relevant products are critical to the Texas Lottery's success in achieving its revenue generation mission for the state of Texas. Equally important is execution related to product placement. It is critical that products are conveniently and widely available at a variety of locations frequented by consumers.

The Texas Lottery retailer base is made up of approximately 16,800 licensees. Although the base contains a variety of trade styles, convenience and grocery stores are the dominant trade-style segments. Together, these two trade styles comprise approximately 90 percent of retailers and more than 95 percent of Texas Lottery sales. Convenience and grocery stores are considered to be traditional lottery trade styles. Other common retail trade styles – such as general merchandise, pharmacy and “big box” – are typically categorized as non-traditional lottery trade styles, as they have not broadly adopted the lottery category as a standard product offering.

Challenges and Opportunities

The Texas Lottery must continue to work to maintain its presence and relationship with traditional lottery trade styles, while actively pursuing opportunities to expand into non-traditional lottery trade styles. There are several challenges to expanding lottery distribution channels. Independently owned retailer establishments are often focused on offering higher profit-margin products that can be more easily correlated to bottom-line revenue. As lottery products produce lower profit margins than many other retail products, prospective retailers' interest in adding the lottery category can be limited. Also, the instant

product category can present operational concerns associated with inventory control/shrinkage and the potentially labor-intensive nature of lottery products can serve as barriers to interest.

Recruiting chain establishments in non-traditional lottery trade styles presents other challenges. The Texas Lottery, lottery operator and North American Association of State and Provincial Lotteries (NASPL) representatives have consistently identified the following barriers to recruiting national corporations representing new trade styles: ability to offer self-service and route sales models, lack of standardized licensing and accounting processes across all jurisdictions, and the availability of new technologies providing back-office accounting and real time connectivity to sales information. Additionally, some retailers perceive that selling lottery products may not align with their business model.

Many prospective retail trade styles are best suited for player-controlled, self-service sales due to consumer traffic patterns and trade-style business models. These different sales methods require unique equipment and support that are not a part of the traditional clerk-assisted transaction model typical to the lottery industry for decades. During the 82nd Legislature, House Bill 1955 was filed to permit the Texas Lottery Commission to contract with or license a lottery operator as a retailer. This bill would have facilitated the self-service and route sales styles of business models mentioned above, but it did not pass.

Key Initiatives

In order to successfully pursue broader distribution channels for its products, the Texas Lottery must meet the needs and concerns of potential new businesses and trade styles. The Texas Lottery recently completed a new lottery operations and services procurement which provides key infrastructure and support to position the agency for future recruitment success. Key among these is a fully refreshed equipment platform for retail featuring state-of-the-art player-activated, self-service equipment; dedicated lottery operator personnel focused solely on individual and small chain business recruitment opportunities; lottery operator support for route sales licensing models that mitigate business overhead related to retailer lottery participation; and new systems that will allow the Texas Lottery to provide its licensees with Web-based accounting and sales information detail far beyond current capabilities.

The Texas Lottery is also continuing to work with NASPL and the Petroleum Convenience Alliance for Technology Standards (PCATS) to create lottery industry standards for transmitting financial and inventory data to retailers. These standards should remove one of the more significant obstacles to recruiting national specialty/general merchandise and big-box stores.

The agency and lottery operator staff will continue to actively work together to enhance retailer recruitment efforts to increase the Texas Lottery's overall presence in a broader array of trade styles. These efforts have

already begun to show promise as recent pilot programs have been initiated with non-traditional lottery trade styles and discussions are underway with other businesses previously hesitant to embrace the lottery category.

Supply Chain Management

Background

Effective supply chain management is critical to ensuring the success of any product at its point of purchase. Product suppliers must ensure that product inventory is distributed timely and in appropriate quantities to retailers and collected timely at the end of the product life cycle.

Implementation of an integrated supply chain system supports the development of stable product distribution channels as well as the efficient management of product delivery. Through its lottery operator, the Texas Lottery uses a predictive ordering software system that evaluates retailer inventory levels and develops unique order quantities for each location based on the existing instant ticket pack inventories at each location. This system allows the Texas Lottery to ship adequate reserve quantities of instant ticket game inventory for the approximately 85 to 90 games introduced each year. The Texas Lottery warehouse was responsible for the distribution of almost nine million packs of tickets to retailer locations in FY 2011.

Challenges and Opportunities

The Texas Lottery already uses an advanced supply chain distribution system based on the lottery operator's predictive ordering model. However, the challenge is to continue to improve service and execution to retail in the delivery of products. Equally important in the supply chain equation is the efficient collection of unsold inventory from retail to create space for new product and provide efficient credit to retailers, limiting overhead associated with lottery.

Key Initiatives

Through its lottery operator, the Texas Lottery will be deploying a number of new and advanced technologies and innovations focused on enhanced supply chain management.

Enhanced Predictive Ordering Software

The lottery operator deployed its first predictive ordering system for the Texas Lottery in the 1990s. While the ordering algorithms have been modified for efficiency over time, the current predictive ordering system

still relies on pack level analysis of inventories at retail. Under the new contract, the lottery operator will be deploying its Automated Distribution Instant System (ADIS), a significantly more sophisticated predictive ordering system, which will evaluate inventory levels within packs for each game based on validation data from those games. The system also evaluates a significant number of other proprietary factors in determining inventories. These factors allow the system to more closely determine exact inventory levels at each location, further refining inventory distribution.

Inventory Return Efficiencies

Through its lottery operator, the Texas Lottery will be deploying a number of technologies that will enhance inventory return and expedite retailer inventory credit. Lottery sales representatives (LSRs) will be equipped with mobile devices that allow them to have near real-time system access to review a retailer's current inventory, allowing the further optimization of ordering tickets and processing returns. Upon collection of returns, LSRs will place returned orders in packing containers equipped with radio frequency identification (RFID) tags. The instant ticket warehouse, which is equipped with RFID antennas, captures returns in real time upon arrival at the warehouse. Returned packs are then processed and sorted by automated return scanning technology, expediting the allocation of packs for redistribution or reconciliation and eventual destruction.

Dual Communication Terminals

While much of the attention in the lottery industry associated with supply chain management is on distribution and collection of instant ticket product inventory, system uptime, including the availability of terminals to generate on-line ticket transactions at retail, is of equal importance. Through its recent lottery operations and services procurement, the Texas Lottery was able to secure sales-stream protection through new communications technology. The lottery operator now provides dual communications connectivity to 30 percent of all retail locations representing more than 50 percent of all retail sales for on-line products. This technology acts as a backup to the primary communication connection for transactions. Should the first connection fail, the secondary connection takes over as primary, allowing for sales transactions to continue without disruption.

Retailer Incentive Program

Background

The Texas Lottery received authorization and funding from the legislature via a rider to reflect an additional one-half (0.5 percent) percent allocation of gross sales for sales performance commissions or

similar sales performance incentive programs beginning with the FY 2010-11 biennium. This budgetary allocation was over and above the standard 5 percent commission that is paid to retailers based on sales.

After studying other lottery retailer incentive programs and evaluating standards in the retail industry for measurement of sales performance, the agency worked to develop a same-store sales growth program that incentivized retailers based on performance. The retailer incentive program is designed to reward retailers who meet and exceed their sales goal using a two-phase approach:

- Phase I: Eligible retailers are required to meet a specific sales goal in order to receive an incentive payment.
- Phase II: Retailers who reach their goal in Phase I are also automatically qualified to receive entries into a random drawing for additional cash prizes. Retailers continue to receive additional entries as they reach new sales milestones.

At the end of FY 2011, the agency had completed a total of five 13-week retailer incentive programs since program introduction in September 2009. Participating retailers generated more than \$290 million in additional sales yielding more than \$49 million in additional revenues to the state during these programs. Qualifying retailers have received incentive payments totaling more than \$25 million for these sales efforts.

Challenges and Opportunities

The agency must continually evaluate its incentive program to ensure that the design of the program is appealing to retailers, resulting in high levels of retailer participation and yielding increased sales and revenue. It is also important that the agency closely communicates with its retailers both directly and through the lottery operator sales force to ensure that the program design remains optimized.

Key Initiatives

The Texas Lottery is the only lottery in the industry that incentivizes retailers based on true same-store sales performance. As the agency is an industry leader in this area, it must monitor its program closely, obtain feedback from its retailers and sales force, and identify opportunities to modify future program parameters based on the results of each of its in-market programs.

Advertising and Communications

Background

The Texas Lottery engages in advertising to communicate with the public about the numerous products offered by the agency each year. The agency makes considerable efforts to appropriately and effectively allocate its advertising dollars to reach the public and optimize revenue, and enhance awareness of Texas Lottery games. The Texas Lottery Commission's advertising is allocated among 20 designated market areas (DMAs) throughout the state, using a combination of mass media (television, radio, newspaper, billboards, Internet) advertising and point-of-sale (flyers, brochures, posters, etc.) materials.

Research from the University of Texas conducted in 2006 suggests that for each additional dollar in lottery advertising expenditures, an additional \$5 to \$25 in additional lottery sales can be anticipated.

Challenges and Opportunities

Shrinking Advertising Dollars

The purchasing power and reach of the Texas Lottery's advertising budget has declined significantly over the nearly 20 years of its existence. The Texas Lottery's advertising budget has diminished in nominal dollars from \$40 million in 1993 to \$32 million in 2011. However, the effects of inflation are even more pronounced. An advertising budget of \$40 million in 1993 dollars would equate to \$59.1 million in 2010 dollars adjusted for inflation.

Add to that the greatly expanded product mix, and it becomes apparent that the agency faces significant challenges in advertising and communicating with the public about all of its products. In 1993, lottery products consisted of one on-line game (*Lotto Texas*) and two instant games. Today, the Texas Lottery offers seven different on-line games with three different add-on features, and approximately 85 to 90 instant games each year.

Furthermore, in 1993, players were easier to reach frequently via network television and radio advertising. Since then, the advertising industry has encountered dramatic change including the proliferation of new media choices for consumers. Just a few examples of new media include the introduction of the Internet and social media, growth in cable channels, and the launch of satellite radio. This market dilution means it is becoming more difficult to reach large groups of consumers with the same level of media expenditures.

Since 1993, the population of Texans over the age of 18 has increased by 45 percent from 12,564,393 to

18,155,095 in 2010. Additionally, the population of Texas has become more ethnically diverse, reaching minority-majority status in recent years. The increased population and decreased advertising budget have combined to lower per capita advertising expenditures over this period by 47 percent from \$3.17 to \$1.68.

The following table summarizes and compares the major challenges impacting the Texas Lottery's advertising over time.

TEXAS LOTTERY ADVERTISING OVERVIEW		
	1993	2010
Advertising Budget	\$40 million advertising budget	\$32 million advertising budget in today's dollars, which is of significantly lower value than the same amount in 1993 when considering increasing media costs and present value of money
Advertising Spending Per Capita	\$3.17 advertising spending per capita <ul style="list-style-type: none"> • \$40 million advertising budget to 12.6 million Texans 18+ 	\$1.68 advertising spending per capita <ul style="list-style-type: none"> • \$32.4 million advertising budget to 18.15 million Texans 18+
Increase in Products	TWO <ul style="list-style-type: none"> • <i>Lotto Texas</i> • Two Scratch-off Games 	EIGHT+ <ul style="list-style-type: none"> • <i>Lotto Texas</i> • Scratch-offs (approx. 90 launched) • <i>Pick 3</i> • <i>Cash Five</i> • <i>Texas Two Step</i> • <i>Mega Millions/Megaplier</i> • <i>Daily 4</i> • <i>Powerball/Power Play</i>
Product Life Cycle	Lottery product was brand-new, generating immense excitement and interest.	Lottery products are mature, meaning that advertising dollars must work harder to create player excitement and interest in the games. New games, game changes and add-on features continue to be introduced, all requiring additional advertising support.
Free Media Exposure	Extensive coverage of winners, games and ball drawings.	Extremely limited coverage of positive news stories like winners and almost no coverage

		of live drawings.
Texas Population Make-Up	Caucasians made up the significant majority.	Population is more diverse with a majority minority population.
Media Proliferation	Players were easy to reach frequently via TV and radio advertising.	The advertising industry has encountered dramatic challenges with the proliferation of new media choices for consumers, including the introduction of the Internet and social media, growth in cable channels, and the launch of satellite radio, all factors that limit advertising exposure. This market dilution means it is becoming more difficult to reach large groups of consumers with the same level of media expenditures.
Pay at the Pump	Since pay-at-the-pump technology was new and limited, most people went into the store to pay for gas, allowing for exposure to lottery products.	Almost 90 percent of stores have pay-at-the-pump technology, and about 60 percent of consumers use it, requiring advertising to work harder to drive players into the store for lottery products.

Statutory Limitations on Types of Advertising

Statutory provisions also affect the type of messaging the agency can use in its advertising. Section 466.110 of the Texas Government Code states that advertisements or promotions sponsored by the Texas Lottery must not be of a nature that unduly influences any person to purchase a lottery ticket or number. This general restriction can be broadly interpreted and significantly limits both the types of advertising messages and the media placement strategies employed in the agency's messaging. The agency is very respectful of and sensitive to the viewpoints of the approximate one-third of Texans who are not in favor of gaming in any form.

Key Initiatives

The Texas Lottery must engage in creative strategies to optimize its advertising expenditures. Additionally, the agency must work to reach new consumers that may not be exposed to traditional advertising vehicles.

Tiered-Media Markets

The Texas Lottery continues to evaluate the effectiveness of its advertising media placement strategies. Due to budgetary constraints, the agency implemented a tiered ranking process to make discrete choices in the weighting of its advertising in the different advertising markets in Texas. This means that the agency's advertising presence in some markets is 'underweighted' due to budgetary limitations, but ultimately results in the most efficient allocation of resources to reach the broadest population of consumers.

Social Media

The Texas Lottery is also exploring opportunities to communicate with consumers about its products through non-paid resources. Many of these opportunities reside in the social media space. The agency is actively evaluating the launch of a Facebook presence and will continue to explore other social media tools that will allow the agency to connect with consumers and engage them regarding Texas Lottery products.

Consumer Electronic Communications and Applications

The Texas Lottery also has begun engaging its players directly through an opt-in e-mail or text messaging program that provides winning numbers, current estimated jackpot alerts, instant game information, and general news and alerts. The Texas Lottery plans to work with its lottery operator on the development of smartphone applications that will deliver similar information and other features to consumers.

Consumer Protection Initiative

Background

Consumer confidence and trust in the Texas Lottery's ability to conduct its games fairly and honestly are at the core of player willingness to participate in lottery games. The Texas Lottery emphasizes integrity and responsibility through the security of its games, systems, drawings and operational facilities. This commitment is exemplified in the agency's ongoing effort to create an environment where players can participate in the games, determine the outcome of their participation and be paid prizes.

The agency has embarked on numerous consumer protection initiatives to provide additional protection for lottery consumers and ensure retailers comply with rules related to prize validations. The centerpiece of these efforts was initiated by the agency in 2004 with the introduction of the Compliance Activity Monitoring Process (CAMP) hotline. The hotline provides consumers with a mechanism to notify the Texas Lottery Commission of jurisdictional concerns. CAMP staff monitor complaints and violations of the Bingo Enabling Act, State Lottery Act and respective administrative rules. An automated system provides the ability to track all complaints and violations from initial intake or discovery to final disposition, which

facilitates trend analysis and reporting. The program is publicized via the agency website and signage in retailer locations.

Several of the agency's other consumer protection-related initiatives that have already been implemented are listed below.

- Dual validation receipt (one for players and one for retailers)
- Split/floating validation numbers (VIRN)
- Removing validation codes
- "Sign Your Ticket" campaign
- PDF 417 barcode on scratch-off tickets for self-check equipment
- Player-activated terminals for self-checking winning status of tickets
- Self-check terminal locator on website
- Terminal inquiry/validation tones
- Transaction display devices for terminals
- Security spotlight on Web page
- Purchase day, date and time printed on on-line game tickets
- Monitoring of validation activity at retail

Another important element of the agency's consumer protection efforts focuses on its retail licensees. The agency continues to work to enhance retailer-training materials to stress ethical standards and the consequences of rule violations. The agency has established administrative rules that provide for a progressive disciplinary process for violations of the Act and rules. Every effort is made to ensure that a retailer's noncompliance with the Act and rules results in timely and consistent application of progressive disciplinary remedies up to and including the revocation of sales licenses. The agency recognizes the need to protect consumers while simultaneously not inconveniencing or disturbing honest retailers. As the vast majority of retailers serve their customers in an ethical and forthright manner, it is critical for the agency to balance consumer protection with retailer motivation to sell lottery tickets. The agency's mission to generate revenue for the state of Texas is supported by making every effort to ensure fun, positive lottery player experiences.

Challenges and Opportunities

Without confidence in the security and integrity of lottery games, consumers might choose not to participate in the games. The Texas Lottery is focused on creating a culture of compliance and trust with its retailers and players. This requires that the agency remain ever vigilant in all areas of its operations as there are individuals that would exploit gaps or weaknesses if they existed in the agency's operational security.

Key Initiatives

With advancements in technology, the agency's resources and tools for monitoring every aspect of its operations become more refined and sophisticated. The agency's new lottery gaming system offers an expansive data warehouse of information on all aspects of lottery transactions and system activities that can be leveraged by the agency through reporting tools to ensure secure operations. The Security Department and Enforcement Division are at the forefront of leading the agency in these initiatives.

These same technological advancements have led to a number of the initiatives listed above. The agency will closely monitor these advancements to identify new opportunities that will further enhance the security of the lottery playing experience.

The Texas Lottery will also continue to alert consumers about security issues via its Security Spotlight section on the agency's website.

Charitable Bingo Operations Business Plan

Note: With regard to charitable bingo, the Texas Lottery Commission is charged with licensing and regulating an industry that generates revenues for nonprofit organizations in Texas. This is an important distinction that statutorily limits the Commission from adopting strategies and action plans that would promote consumer participation in bingo playing.

Charitable Bingo Today

Business Description and Historical Perspective

In November 1980, Texas voters approved a constitutional amendment authorizing charitable bingo on a local option basis. The amendment required all bingo proceeds to be spent in Texas for charitable purposes. The first bingo licenses were issued in the spring of 1982; at that time, charitable bingo was a division at the Comptroller of Public Accounts. In January 1990, the regulation and administration of charitable bingo was transferred to the Texas Alcoholic Beverage Commission. In April 1994, the administration of charitable bingo was transferred to the Texas Lottery Commission.

The Charitable Bingo Operations Division (CBOD) is charged with the strict control and close supervision of bingo conducted in Texas to ensure bingo is fairly conducted and the proceeds from bingo are used for an authorized purpose.

The primary functions of the CBOD are the oversight of the licensing, accounting, and auditing of charitable bingo activities based upon the Bingo Enabling Act and the Charitable Bingo Administrative Rules.

In addition to the CBOD's mission statement, the division developed the following regulatory objective:

Charitable bingo is an important fund-raising activity for a variety of Texas nonprofit organizations. The Charitable Bingo Operations Division of the Texas Lottery Commission is charged with the strict control and close supervision of bingo conducted in this state so that bingo is fairly conducted and the proceeds from bingo are used for an authorized purpose. Our goal is to achieve voluntary compliance and assist licensees through training and education.

We will strive for the highest levels of professionalism, conducting our regulatory activities fairly,

competently and consistently. We will develop clear regulatory requirements in an open environment, encouraging two-way communication.

Customers and Beneficiaries

Customers

Customers of the CBOD are: licensed organizations including nonprofit organizations, commercial lessors, manufacturers, and distributors; the Legislature; members of the public who play bingo, the Texas Lottery Commissioners and agency staff, and ultimately those who benefit from the charitable distributions derived from bingo activities and the net revenue contributions to the state of Texas. The charitable bingo player base consists primarily of adult Texans 18 years and older; however, it is not required that a bingo player be 18 if accompanied by a parent or guardian.

Beneficiaries

Providing authorized nonprofit organizations the opportunity to raise funds for their charitable purposes by conducting bingo improves the lives of many Texans. In calendar year 2010, reported charitable distributions from bingo activities were \$33,905,701, while the minimum required charitable distributions for 2010 were \$8,392,575. Reported charitable distributions have continually exceeded the amount required to be distributed by statute.

Local jurisdictions benefit from charitable bingo activity in the form of allocations derived from fees collected on bingo prizes. A county that imposed a gross receipts tax on the conduct of bingo as of January 1, 1993, is entitled to 50 percent of the bingo prize fee collected under § 2001.502 of the Bingo Enabling Act on a prize awarded at a game conducted in the county. A municipality that imposed a gross receipts tax on the conduct of bingo as of January 1, 1993, is entitled to 50 percent of the bingo prize fee collected under § 2001.502 of the Bingo Enabling Act on a prize awarded at a game conducted in the municipality. If a county and municipality are both entitled to a share of the fee imposed by § 2001.502, then the county is entitled to 25 percent of the fee on a prize awarded at a game conducted in the county; and the municipality is entitled to 25 percent of the fee on a prize awarded at a game conducted in the municipality.

In 2010, counties received \$6,446,725.41 in allocations and municipalities received \$5,891,841.90 in allocations from the conduct of charitable bingo. Allocations to counties and municipalities have increased yearly from 2002 through 2010.

In addition to the fees collected from bingo prize winners, the CBOD receives license fees, rental tax and administrative penalties. In 2010, \$18,294,872.69 was deposited into General Revenue and an additional \$12,338,567 was allocated to cities and counties that elected to share in the prize fee collections.

Management and Organizational Structure

The director of the CBOD is responsible for the day-to-day operations relating to the regulation of charitable bingo, and ensuring that the staff carries out applicable state law and policies of the Texas Lottery Commission. The CBOD is also responsible for approving bingo products, disposable bingo cards, pull-tab bingo tickets and bingo card-minding devices, prior to sale, lease or use in Texas.

The three-member Texas Lottery Commission sets policy, promulgates rules for the agency, and performs all other duties required by law. The Governor appoints Commission members, with the advice and consent of the state Senate, to staggered six-year terms. One Commission member must have experience in the bingo industry.

The CBOD is divided into two departments, Audit Services and Taxpayer Services, which collectively regulate charitable bingo. Each department has a manager who reports to the director. The Audit Services Department is comprised of five regional offices located in Austin, Dallas, Houston, Odessa and San Antonio.

Financial Overview and Assessment

Overview

The Texas Legislature establishes the agency's appropriations on a biennial basis. The agency's budget is prepared with direct input from division management, reviewed by executive management and approved by the Commissioners. The budget serves as the foundation for the agency's financial planning and control.

In May 2010, the Legislative Budget Board and Governor's Office requested that as a starting point for the agency's FY 2012-13 baseline appropriation request, general revenue related funds could not exceed the sum of the amounts expended in FY 2010 and budgeted in FY 2011 adjusted to reflect a full 5 percent reduction.

Approximately 85 percent of the CBOD's FY 2012-13 appropriation consists of the statutorily required allocation of bingo prize fees to counties and cities. This is strictly an appropriation of pass-through funds. The CBOD is charged with the collection and processing of the prize fees submitted by the licensed authorized organizations conducting bingo. A portion of those prize fees collected is remitted back to the local jurisdictions where the bingo games are conducted. This estimated amount was included in the CBOD's appropriation as a separate strategy beginning in FY 2004. If the amount of prize fees collected exceeds the estimated appropriation, then a contingency rider attached to the appropriation allows for this estimated amount to be increased without impacting any of the other strategies. On the other hand, should the amount collected fall short of the appropriation, the remaining balance of this strategy cannot be transferred to any other strategy. As a result, in order to meet the 5 percent budget reduction for FY 2012-2013 required by the Legislative Budget Board, Governor's Office, Speaker of the House and Lieutenant Governor, the administrative portion of the CBOD's appropriation was reduced by 27 percent. This reduction included a decrease of 12 full-time-equivalent staff members in the CBOD and a reduction in salaries and other operating costs by \$1,553,349 over the next biennium.

For the 2012-2013 biennium, House Bill 1 (HB 1) established appropriations for the General Revenue Account in the amount of \$14.8 million in FY 2012 and \$14.8 million in FY 2013 to regulate and administer all charitable bingo activities in the state of Texas. The funds have been allocated to strategies as shown in the following table:

Texas Lottery Commission
Budget by Strategy (In Millions)

Strategy	FY 2012		FY 2013	
	\$	%	\$	%
Bingo Licensing	0.7	5.05%	0.7	5.05%
Bingo Education & Development	0.1	0.95%	0.1	0.95%
Bingo Law Compliance Field Operations	1.1	7.17%	1.1	7.17%
Bingo Prize Fee Collections & Accounting	0.2	1.20%	0.2	1.20%
Bingo Prize Fee Allocations	12.6	85.62%	12.6	85.62%
Total*	\$14.70	100%	\$14.70	100%

*Numbers may not sum due to rounding.

Bingo Prize Fee Allocations make up approximately 85 percent of Charitable Bingo's budget. Allocations are the result of prize fees collected by nonprofit organizations that conduct Charitable Bingo games from players who won bingo prizes. Revenue from this fee is an important source of income for many cities and counties. Approximately \$12.3 million was allocated back to local jurisdictions in 2010.

In calendar year 2010, gross receipts from charitable bingo totaled \$699 million, bingo prizes awarded were \$526 million, and charitable distributions totaled approximately \$33.9 million.

Planning for the Future

General Industry Environment Trends

Charitable bingo competes in a mature market for the discretionary entertainment dollars of Texans. Charitable bingo activities support the efforts of nonprofit organizations to raise funds for their charitable purposes. Additionally, taxes and fees collected from the conduct of charitable bingo are remitted to the state's General Revenue Fund.

Markets and Demographics

The charitable bingo player base consists primarily of adult Texans 18 years and older; however, it is not required that a bingo player be 18 if accompanied by a parent or guardian. Charitable bingo players tend to be Caucasian, married, female and over 65 years of age with a high school education and annual income of less than \$25,000. This dominant demographic highlights the cultural and social aspects of the games that align with older Texans. Attendance at licensed bingo games was approximately 17.6 million in 2010.

Opportunities, Challenges and Risks

The emergence of the on-line gaming market and the expansion of gaming in neighboring states present a challenge for the bingo industry in years 2012-2015. Additionally, smoking bans implemented in local jurisdictions in Texas have impacted the bingo industry.

External Initiatives

Legislative Resource

The CBOD will continue to serve as a resource to the Legislature on items that would impact the charitable gaming industry in Texas. Toward this end, the CBOD will continue its research of charitable gaming activities and regulatory practices in other gaming jurisdictions and will also continue to respond to requests for information in a timely manner.

Industry Groups as a Resource

Organized industry groups provide information to the Commission that is relative to different aspects of the bingo industry in Texas. This information provides stakeholder input into the development of policies and guidelines related to the regulation of bingo. These groups provide a broader perspective of needs and concerns for the various industry group members comprised of all classes of licensees. Working collaboratively with industry groups has the potential for licensees to achieve higher levels of compliance with the Bingo Enabling Act and Charitable Bingo Administrative Rules.

Continue to Update and Make Available Public Service Announcements

Bingo public service announcements (PSAs) provide information on charitable bingo activities in Texas to the general public. The PSAs are developed internally at nominal cost and made available to licensees to provide to their local media outlets to promote and stimulate interest in their area. PSAs have the potential to improve the public's awareness of the benefits of charitable bingo and have a direct impact on community-based charitable bingo activities.

Quarterly Press Releases

Press releases are issued following each calendar quarter reporting period. These press releases highlight allocations to local jurisdictions from the bingo prize fees collected as well as the charitable distributions report by licensed authorized organizations.

Charitable Bingo Annual Report

The annual report is researched and developed internally and published on the website. It provides information that includes gross sales, attendance, prizes awarded, charitable distributions, licensing trends, division accomplishments and other relevant data. In addition, it provides a comparison to previous years.

Adoption of Administrative Rules and Guidelines to Better Ensure Licensees a Fair, Consistent, and Open Regulatory Experience

As the regulator, the CBOD has the responsibility to clarify and communicate expectations to licensees that participate in bingo and to ensure statutory objectives are met.

Internal Initiatives – Operational Support and Improvement

Evaluating Organizational Structure and Responsibilities

Due to the limited funding and reduction in staffing levels, the CBOD will continually evaluate work flow processes to maximize the efficient use of resources.

Employee Communication

Monthly headquarters and regional audit office staff meetings are held so that information is shared and disseminated to all CBOD staff.



2012-2015



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