



it's good to play

Transition Document, Executive Cabinet, Tier Two Report

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Budget Summary:

The Lottery's 05-07 Biennium Budget is comprised of three funds. The Lottery is self-sustaining and finances all Lottery expenditures from sales of Lottery entertainment products.

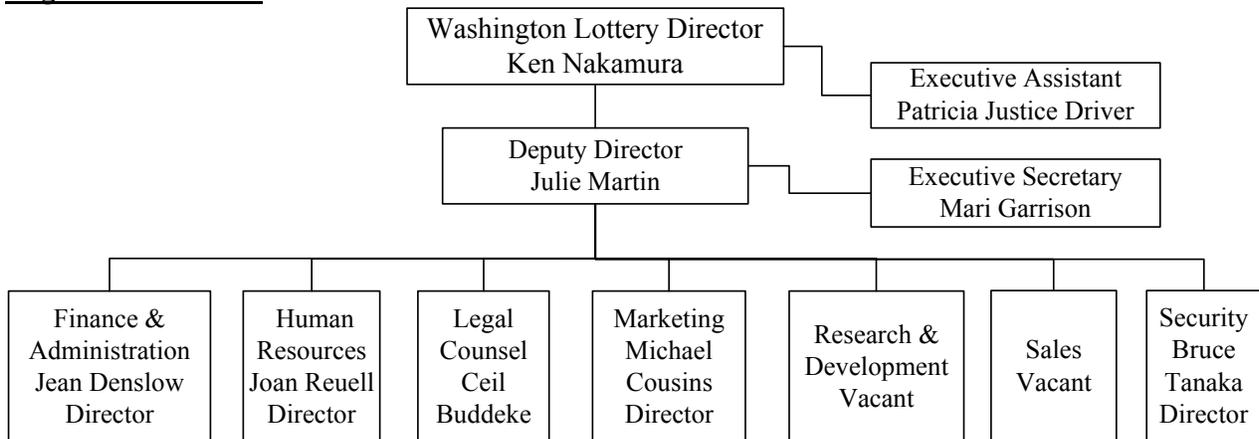
- Fund 433 collects proceeds of the multi-state game, *Mega Millions*, and disburses prizes, retailer commissions, and other game-related moneys in support of *Mega Millions* sales
- Fund 577 collects proceeds from all other Lottery games, and disburses prizes, retailer commissions, and other game-related moneys in support of all other Lottery games.
- Fund 578, financed from proceeds of all Lottery games, funds staffing and other operating costs in support of all game sales.

Funds 433 and 577 are non-appropriated; Fund 578 is appropriated.

All Lottery disbursements in the 05-07 biennium go to state-mandated beneficiaries, in the following order:

- Safeco and Qwest stadiums \$24.9 million (based on a mandated 4 percent per year increase for inflation)
- Education Construction \$180 million
- (General Fund, only after stadium debt is funded and when moneys directed toward education exceed the cap of \$102 million in one year)

Organization Chart:



In addition, there is a Lottery Commission, comprised of five members appointed by the Governor to rotating six-year terms.

About our Management Team:

Ken Nakamura, Director

Appointed Director, effective November 12, 2003, Ken brings to this position a diverse private sector business management background. The Director is responsible for carrying out legislative mandates and laws related to the Lottery. Ken leads a Management Team of eight, responsible for the overall administration of the agency, consisting of 150 employees statewide.

Julie A. Martin, Deputy Director

Appointed by Director. Oversees Sales, Marketing, and Research and Development divisions. Responsible for managing the profitability of Lottery games and related vendor costs, and serving as lead legislative liaison. Has served the Lottery for three and one half years, after working for 20 years in private industry as a manager and sales representative.

Bruce Tanaka, Security Director

Oversees the division charged with keeping the integrity and the public's confidence in Washington's Lottery high. Scope includes oversight of employees, retailers and contractors of the Lottery. Supervises investigators, an information security specialist, and a security assistant.

Joan Reuell, Human Resource Director

Responsible for administration of the Human Resources division. Ensures uniform administration of personnel programs such as recruitment and selection, classification and pay, performance evaluations, merit system rules, union contract compliance, training and career development, equal employment opportunity, and the Quality Program.

Ceil Buddeke, Legal Counsel

Manages the Legal Unit, which provides legal analysis and advice regarding administrative hearings, conflict of interest and ethics, contracts and competitive procurement, prize payment, retailer licensing, public records and administrative rules.

Jean Denslow, Finance and Administration Director

Promoted to Director of Finance and Administration in 2002 after serving five years as the Finance Manager. Provides guidance and direction for agency activities in the areas of budgeting, accounting, analysis and reporting, cash management, purchasing, warehouse and distribution services, facilities, transportation and other administrative functions.

Michael Cousins, Marketing Director

With the strength and support of a team of 13, focuses on marketing and communications. Has a strong marketing background with high profile retail companies. Joined the Lottery in September 1999. Oversees public relations, advertising, promotions, and product development.

Patricia Justice Driver, Executive Assistant

Has served as Executive Assistant to five Directors during her eight years at the Lottery. Provides executive-level support to the Director, and manages the budgets for the Director's office, agency out-of-state travel, and agency furniture.

Mari Garrison, Executive Secretary

Provides administrative support to the Director, Deputy Director, and a five-member Commission. Provides occasional administrative support to other members of the Director's Office. Prepares necessary materials and documentation in preparation for discussions with Commissioners, the legislature, other agencies, constituent groups, and the public.

Authorizing Environment and Environmental Scan

Our major statutory authority is Chapter 67.70 RCW ("State Lottery"), the statute that created and defined the Lottery and the Lottery Commission.

Major partner and supplier groups

- **Retailers:** The approximately 3,500 retailers selling Lottery tickets are the Lottery's most important business partners. They represent not only the distribution network for Lottery products, but they are also the main point of contact with the players who participate in our games. The Lottery works with retailers not only to encourage the promotion and sale of Lottery products at retail, but also to ensure that Lottery products are represented favorably with the public. It is incumbent upon the Lottery to continue to review its business relationship with retailers and to seek ways to improve that relationship through constant refinement of the Lottery's business practices.
- **GTECH:** GTECH Corporation is the leading global supplier of systems and services for the Lottery industry. The company designs, produces, implements, operates and services computerized on-line networks. GTECH is the Lottery's combined on-line and *Scratch* operations vendor and, as such, plays a critical role in the distribution of tickets, sales tracking, validations of winning tickets and the Lottery's overall integrity and accountability. The company also provides the Lottery with new and revised game concepts, systems modifications, information about other lotteries and assistance with servicing retailers. With its acquisition of Interlott Technologies, GTECH has also become the Lottery's provider of Instant Ticket Vending Machines (ITVMs). ITVMs provide player convenience through automated dispensing of *Scratch* tickets from machines that can offer up to 24 different games at one time.
- **Scientific Games Corporation:** Scientific Games Corporation is also a world leader in providing a full range of premium-quality lottery products, integrated systems and support services to legally licensed lotteries in more than 50 countries. The company also provides promotional games and related services to companies in the private sector. Scientific Games produces the Lottery's instant (*Scratch*) ticket games. In addition to manufacturing the tickets, Scientific Games provides assistance in game design, production planning and game integrity.
- **Publicis:** Publicis is an integrated marketing services company that provides the Lottery both advertising and public relations services. Together with the Lottery's marketing function, Publicis plans and develops the creative materials that provide the basis for the advertising that supports games and sales promotions. Publicis also provides media buying services to maximize the distribution and impact of Lottery advertisements and other marketing messages. Publicis Dialog, Publicis' public relations arm, provides the Lottery with public relations promotion resources.
- **Retailer Associations:** Four major associations that most often represent the retailers with whom the Lottery has developed strong, productive working relationships are the Washington Food Industry, Washington Retail Association, Korean American Grocer's Association, and Washington Association of Neighborhood Stores.
- **Seattle Seahawks:** The Lottery has a legislative mandate to provide funding for construction of Qwest Field, beginning in 1998 and ending in 2020. Simultaneously, the Seattle Seahawks are mandated to assist the Lottery in generating those funds. The Lottery and the Seahawks have developed a strong partnership that includes joint efforts in creating effective advertising, signage, web site links and banner advertisements; training camp, pre-season, and regular season home game promotions; and sales incentives to support the Lottery's consumer and retailer promotions to launch football-themed *Scratch* tickets.

- **Seattle Mariners:** The Lottery also has a legislative mandate to provide funding for the construction of Safeco Field, beginning in 1996 and ending 2015. Although there is not a mandate for the Mariners to assist the Lottery in generating that funding, the Mariners have helped within the rules of Major League Baseball. Lottery funding amounts are defined in statute.
- **BLJ Marketing:** BLJ Marketing specializes in lottery marketing research and consulting and assists lottery clients with marketing issues. These issues often include developing, implementing and evaluating market research programs; moderating focus groups; developing products; evaluating progress and profitability; strategic planning; and advertising creative and image development.

Major customer groups and their expectations

Washington’s Lottery is experiencing shifts in player habits. Traditional lotto-type draw games with drawings once per day or less frequently have historically been more popular with casual players than the Lottery’s instant (*Scratch*) games. Draw games rely primarily on jackpots to appeal to players, whereas instant games attract more consistent and loyal play with their instant-win features and varied themes and play styles.

More recently instant game revenues have overtaken those of draw games. The graph below indicates a generational shift that helps explain this trend. While the Lottery’s draw games are very popular with Baby Boom (40 to 58-year-olds) and older generations, they are less so with younger players. Conversely, instant tickets are much more popular with younger players than with older players.

Three Consecutive Months of 2004 Lottery Game Play, by Age Group

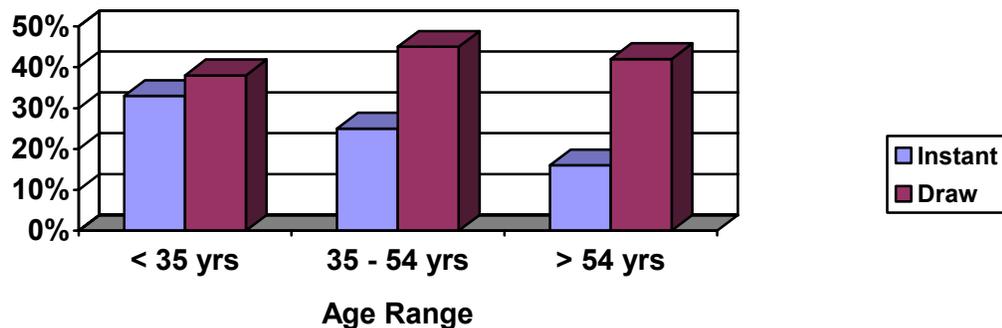


Figure 1: Generational preferences, Instant vs. Draw games

Research shows that younger players find draw games with their relatively infrequent drawings to be dull. They prefer gaming that provides more challenge, immediate feedback and gratification. This phenomenon is consistent with current cultural and technological trends. This age group represents the players of the future. It is important that future Lottery games be able to respond to and satisfy the demands of these and upcoming generations of players.

There is increasing demand for games that can be played on the Internet. Seventy percent of Washington players access the Internet at least one hour each week for personal or business reasons. Of these players, 45 percent have made at least one Internet consumer goods purchase within the last six months. The Internet provides easy access to information and allows purchases and other transactions to be made very conveniently. Nearly 60 percent of all U.S. adult home users purchased goods and services on-line in 2003. Internet gaming volume is expected to reach \$12 billion by 2006.

Highly entertaining mobile, home console and computer games offer social and/or competitive features made possible through networked systems. Such capabilities are very appealing to the 18 to 24 and 25 to

34 year old demographics (40 percent “regularly” participate) – the same demographics that are least likely to play the Lottery (less than one in four are Lottery players). Within the past year, several U.S. lotteries have begun to introduce computer, Internet and/or mobile phone enhancements to meet their customers’ demands.

Emerging Trends

The environment in which the Lottery operates has been changing rapidly and is expected to continue to do so at an even more accelerated pace in upcoming years. General economic factors, player preferences, competitive forces, rapid technological developments and political constraints have profound impact upon the Lottery’s ability to generate the maximum amount of net revenues for the State and to respond to the needs and interests of Washington residents.

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

In Washington, direct legitimate gaming competition to the Lottery comes in many forms.

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

Competitive forces are causing significant erosion to the Lottery’s gaming market share. Figure 2 illustrates the shift in gaming market share from 1996 to 2003.

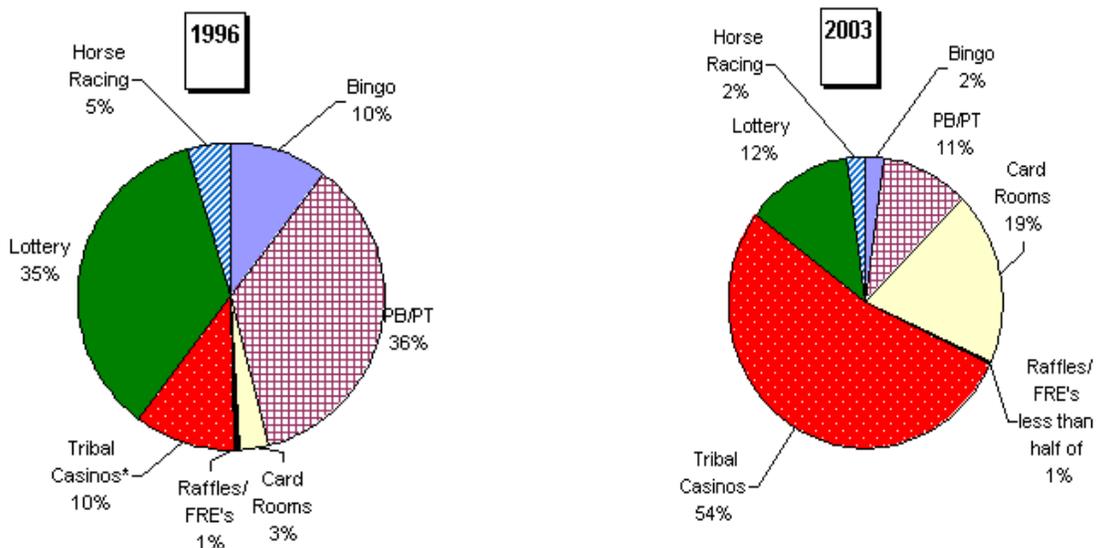


Figure 2: Washington Gaming Market 1996 vs. 2003, Based On Net Win (Wagers Less Prizes)

Source: Washington State Gambling Commission

As Figure 2 demonstrates, in 1996 the two forms of gaming with the largest share of the Washington gaming market were pull-tabs and Lottery at 36 percent and 35 percent, respectively. By 2003, tribal casinos and card rooms dominated the Washington gaming market with 73 percent of the share, with the tribal casinos holding 54 percent of the overall gaming market. The Lottery's share of the market declined to 12 percent, despite steady sales.

In this same time period, net gaming receipts from all forms of legal gaming increased approximately 275 percent - from \$476 million to \$1.31 billion. Figure 3 illustrates Washington gaming trends by activity for the 4-year period ending FY 2003. Only tribal casinos and card rooms experienced growth during this period. The tribal casinos experienced double-digit annual growth. The card rooms' growth appears to be leveling off. All other forms of gaming, including Lottery, experienced steady or declining revenues. (Updated – 2004 – figures are cited in Tier 1 Report, Issue # 2.)

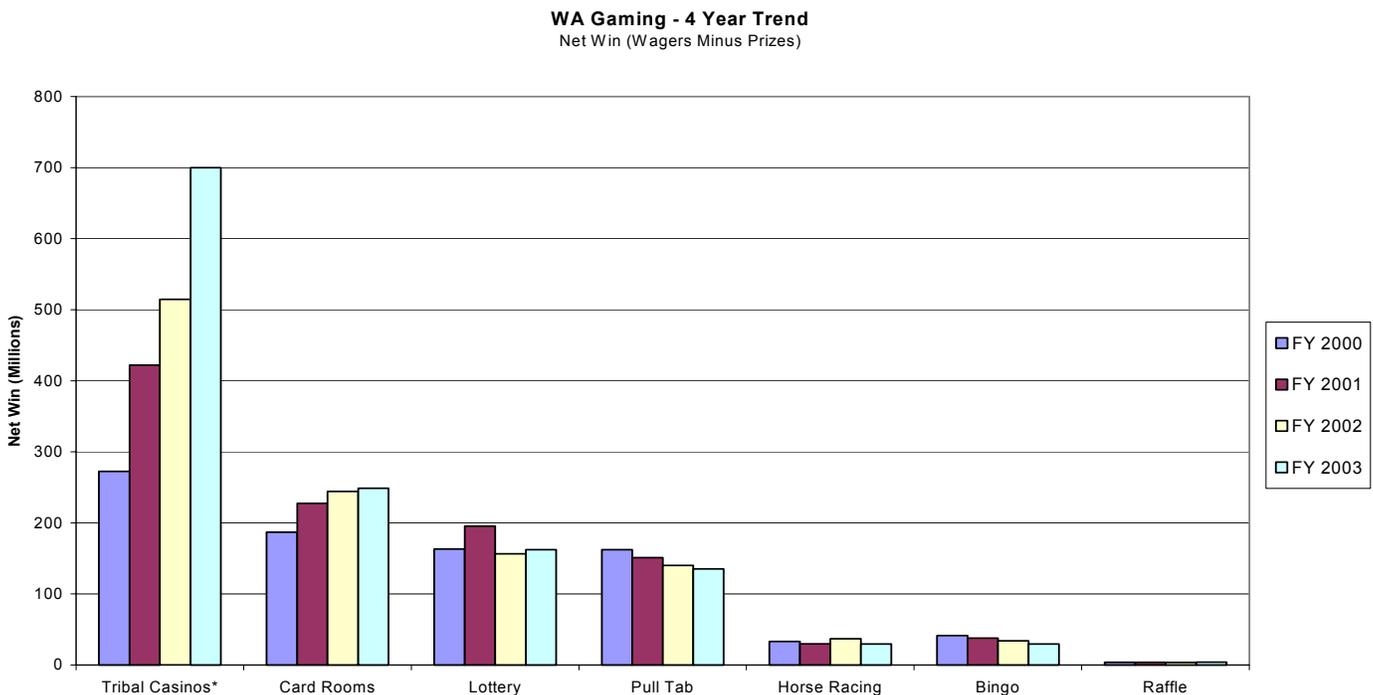


Figure 3: Washington Gaming – 4 Year Trend

Strategic Plan Highlights

▪ **Vision Statement**

Washington's Lottery: leader in public value, first in fun.

▪ **Mission Statements**

Washington's Lottery relies on three distinct mission statements.

Product Mission: To offer imaginative games that bring fun and dreams into people's lives.

Economic Mission: To responsibly maximize our revenues to the State of Washington.

Social Mission: To enhance the quality of life for the people of Washington by financially contributing to education and other community endeavors.

- **Major goals and strategies being used to carry out the agency mission**

FY 05 STRATEGIC PLAN

INSPIRE EMPLOYEES

Enhance Development

- Develop an agency Succession Plan.
- Refresh the employee recognition program.
- Focus on training that addresses individual employee needs and organizational learning gaps.
- Expand outside networking and best practices research.

Improve Internal Communications

- Address the employee satisfaction survey and agency self-assessment findings.
- Expand staff education about Washington Works.

OPTIMIZE SALES

Develop new products and markets

- Identify and prioritize new/niche markets and implement a plan to penetrate these markets.
- Identify and prioritize current and new products within the Lottery's product portfolio.
- Explore new, non-traditional business models.
- Investigate Internet, cell phone, and other emerging technology for product application.

Capitalize on new technology

- Select a new gaming system vendor to replace the current on-line gaming system.
- Develop random number generator usage for drawings.

MAXIMIZE PUBLIC VALUE

Expand Effective Communication

- Explore the benefits of a defined and distinct beneficiary.
- Create and implement a comprehensive Public Value Plan.
- Define and communicate the Lottery brand.

Plan Implementation

Lottery staff is enthusiastically addressing this plan's strategies. New consumer audiences have been identified and exciting, interactive promotions have been designed to meet those customers' needs. Two new games, *Zip* and *Win for Life*, are poised for introduction in Spring 2005. With a nod to overwhelming customer interest in electronic games, the Lottery will also launch new "Cyber" products, which are traditional lottery games purchased and redeemed at a retail site and offering extended electronic play features.

Given that the retail industry is undergoing rapid and massive change, we are exploring and installing new channels of product distribution. In the near future, new self-service hybrid ticket terminals will be deployed. These terminals, which offer both draw and instant games, will allow us to sell tickets in many venues not currently available. "Pop-up" retail, where kiosks can be quickly set up and taken down, then moved to new sites, is one wave of the future for the Lottery.

In January 2005 our sales force will modernize its role by implementing a sophisticated data analysis program that indicates best use of time in the field. By focusing our retailer support on retailers whose historic sales data indicates potential for growth, both the Lottery and the retailers of Washington expect to optimize the potential for Lottery revenue.

SWOT Analysis

... Issues that may affect the Lottery's ability to accomplish its mission

Strengths –

- Has a strong, business-focused senior Management Team leading the agency
 - Has clear, concise strategic and business plans which are used to guide all activity
 - Is staffed by a seasoned, passionate employee base
 - Is able to invite, rather than require, participation from customers
- Has a unique, “for-profit” mission which is energetically supported by its customers
- Successfully runs as a business in a governmental environment

Weaknesses –

- Needs vital strategic direction from the state's executive branch
- May be unable to respond timely to customer needs, and/or to implement new technologies when government regulations and norms constrain business decisions

Opportunities –

- Establishment of a direct, single beneficiary with broad public appeal, such as conservation or educational scholarships, could enhance customer loyalty and our ability to attract new customers, so that we can maximize revenue to the state.
- Moving to a privatized or quasi-public business model could enhance our ability to quickly provide products our customers want, so that we can maximize revenue to the state.

Threats –

- Rapid expansion of tribal gaming and mini-casinos is eroding our market share

Emergent or Hot Issues

Along with long-term issues raised in the Lottery's Tier 1 Report, there are potential short-term issues that may come to the fore in the near future. For all issues, please contact the Lottery Director, Ken Nakamura.

I-892

Passage of I-892, the electronic scratch ticket measure on the November 2004 ballot, would create a “hot issue” to be addressed early in 2005. The initiative's language specifies that the Lottery is charged with licensing a potential 18,225 electronic scratch game terminal operators, with running the central accounting and audit computer system, and with administering the games. We are ready to move as quickly as instructed to implement the voters' decision, and will work in concert with the executive and legislative branches to that end.

Change In Appropriated Status

The Lottery is seeking to become fully non-appropriated. Approximately 2 percent of our budget is currently appropriated. As small as this amount is, it still requires us to maintain a full-fledged budget submittal/approval process and to comply with the state's budget rules and timelines. This is a labor-intensive and slow-moving process, not well-suited to a sales organization which must quickly respond to customer trends. Being fully non-appropriated, will

- allow the Lottery to quickly target resources when needed
- create process efficiencies
- create a positive change in the work culture.

Creating a structure that ensures adequate and appropriate oversight is likely to involve executive and legislative staff insights.

Legislation Watch

While we are unaware of any at this time, legislation may be proposed in the 2005 legislative session which will impact our business processes and/or our outcomes. Innovative and non-traditional gaming opportunities are being adopted by legislatures in other states, and may inspire similar proposals in Washington. Should any new legislation involving either a positive or negative impact on Lottery sales surface, we will expect to provide information to executive staff as they define a position that is best for the state's beneficiaries.

Problem gambling remediation

Informal discussions over the past few years about how to address the issue of problem gambling may result in a legislative or executive branch recommendation early in 2005. The Lottery believes that any such proposal must include all gaming entities and that any financing required to implement a recommended education or treatment program must be assessed proportionately. Viewing only the Lottery's resources as readily available "public" funding will diminish the amount we are able to forward to the state's beneficiaries, and will fail to hold accountable those venues which primarily contribute to the problem.

Legislative Proposals

To date, we have not submitted agency request legislation but we are interested in pursuing a fully non-appropriated status and in moving to one or more multi-draw games to increase sales, having seen other states' success with this option.