

The Future of the Lottery Industry

An interview with Scientific Games CEO Lorne Weil

Scientific Games Inc. is a global marketing and technology leader in the lottery industry. CEO Lorne Weil discusses some of the ways this industry is likely to change and evolve, talks about some of the things Scientific Games is doing to innovate and position itself for an exciting future, and shares his views on politics, the lottery-vendor relationship, and industry advancements.

Paul Jason (PJ): *The political process seems to be stalling a little, with the EU wrestling with the same regulatory challenges we have in the U.S. While PGRI supports the UIGEA and the EU notion of gaming being a “special sector,” it seems to me that we need more clear resolution about how governments should manage gaming. Could you speak to the challenge of integrating these disparate political agendas and inconsistent regulatory policies into a game plan that enables the industry to move forward, to progress and realize its potential?*

Lorne Weil (LW): Disparate political agendas aside, as the industry has little control over the whims of the electorate or administrative fiat world-wide, we are beginning to see the start of a long-needed debate over the “model” of the lottery industry that will frame the coming years. Emerging jurisdictions are likely to attempt adoption of revenue-producing models that will permit the operator – whomever it is – to generate the most dollars. The developing American debate over “privatization” and/or “securitization” will provide executives the opportunity to maximize revenues first before altering the operational or financial structure. Any process developed to “privatize” state-operated lotteries will, by its nature, require “casino-license style” licensing of operators and vendors. That process will require corporate capability reviews and could have a dramatic impact to the “procurement process.” Regardless of jurisdiction, we as an industry must become willing to aggressively and proactively join the cultural debate over the role of gaming entertainment in society in order to effectively balance business goals and corporate responsibility.

PJ: *You say, “We see more requirements for Internet and mobile gaming in RFP’s, including for U.S. lotteries.” What kind of time-line do you envision for U.S. state legislators to enact laws that allow for the implementation of mobile and/or internet gaming strategies, and what form are these laws likely to take?*

LW: As you know the UIGEA is, in general, anti-gaming legislation; however, it does allow for “states rights” when determining if Internet wagering on racing and lotteries should be legal. Since several states have already approved Internet wagering on racing we are seeing a surge in interest from our racing client’s desire to pro-

vide web betting services. This could, in part, be driven by the clarity that the UIGEA provides at the federal level but I believe there is also a realization that an Internet wagering void has been created by this Act that racing seeks to fill.

Lotteries are typically more conservative than commercially run racing corporations and therefore will likely be much slower to seize this opportunity.

Nevertheless, I believe lotteries will eventually take advantage of the expanded distribution and enhanced game content potential that the Internet offers and will move to capitalize on this opportunity once the implications of UIGEA have been fully vetted. Other factors will require technical solutions that lotteries will insist upon before moving forward such as responsible gaming controls, age and location verification. Of course SG is actively working on solutions for all of these issues.

PJ: *You say, in reference to Internet and mobile “...the key to the success of these mediums will not be the devices themselves, but instead the delivery of unique game content that is fun and entertaining.” How will implementation meet the challenge of complying with regulations that vary by jurisdiction, with some game types allowed in some jurisdictions but not in others?*

LW: Both the Internet and Cellular phones offer the opportunity for new and exciting content resulting from their inherent multi-dimensional characteristics of sound, color and motion when compared to the single dimension of traditional paper based lottery products. While we are currently providing lottery wagering services and products via these mediums in some foreign jurisdictions, the full potential is far from realized and will no doubt grow signifi-

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cantly in the years ahead as content is developed that fully exploits the rapidly expanding technical capabilities of PCs, but more importantly, mobile phones. The power of new mobile phones and networks coupled with the “anytime, anywhere” nature of these devices will very likely lead to a new era of lottery content excitement, content that leverages our understanding of how to deliver “instant” gaming experiences to players. SG is the market leader in how to create instant-win gaming experiences. We think this experience is transferable to this medium. SG will be a leader in providing cutting edge products and services in this realm as the opportunities unfold.

PJ: *How will the growth of SG/MDI in North America compare to the growth outside of North America?*

LW: We see numerous opportunities to replicate the growth of the last decade in North America in other parts of the world. One of our prime focuses is developing our Cooperative Services model for instant tickets in lotteries throughout Europe, and, in fact, throughout the world. We have had some early success in Germany and look forward to continuing our initiatives in the months ahead. The Asian market, particularly China, is beginning to open up and provide opportunities for U.S. based vendors. Scientific Games is at the forefront of those efforts.

Additionally, the MDI business is aggressively seeking licenses that have worldwide appeal or specific interests in various countries around the world. 2007 should see the introduction of MDI’s merchandise model for Europe and Latin America as the popularity of licensed games begins to grow across the globe.

PJ: *How are game styles and preferences different throughout the world?*

LW: Our research is cumulative and built on over 30 years of global experience. It suggests that the key determinants of demand are similar country to country, continent to continent. In fact, when lotteries adopt and integrate learned and proven best practices, their performances are often remarkable. Cultural differences may be integrated into game designs. For example, symbols may be used in one culture and numbers in another (where even the numbers themselves might have quite different meanings). However, product value, distribution, merchandising and trust in the games are universal. There is also a developmental curve that we have come to appreciate over the years. Since consumers learn what lottery products teach them over time, product and marketing continuity are crucial. The most successful products are those that are part of an integrated strategy whereas inconsistent, ever-changing, game-by-game marketing tends to erode or limit the development of knowledgeable consumers and agents and so limits financial performance.

PJ: *Could you help us get clearer on the meaning of “convergence?”*

LW: One definition of convergence is when technology or products evolve and combine to create a new solution, while still maintaining the advantages of each initial component, therefore heightening the advantages of the new product.

Certainly, the convergence of Instant and Online games as well as the ability to deliver this content over new channels is one way that we have worked to meet demand for entertainment and excitement.

However, in addition to the technology solutions that enable this type of content, convergence is also about how the games work together and how they are positioned together to effectively reach the consumer. We see this type of convergence as a marketing as well as a technology issue – a way to seize gaming opportunities across a variety of mechanisms that have user involvement. The question is, how to maximize revenue from these gaming opportunities, not just how to enable the new technology solution. We understand the consumer needs and the marketing programs that can make new technology and the convergence of games more productive.

PJ: *At NASPL, a director asked the panel why more resources have not been allocated towards making on-line more fun and exciting. MDI revolutionized Instants in this respect. Will SGI do the same for on-line?*

LW: In the last three years, SGI has already taken a proactive stance to implement new online game content and game categories that deliver better value and excitement to players. The online lottery game portfolio has traditionally included matrix games, numbers games, and outside the U.S., sports-betting games. It has been our mission to create new gaming categories through our Scientific Games Game Generation Group, SG3, which includes a dedicated team of Game Design talent. Similar to instant tickets, many of our new on-line games can be integrated with licensed properties.

PJ: *Can you give us any clues about the on-line content initiatives of your Game Generation Incubator?*

LW: Through the SG3 effort we have developed at least six new categories of games to include Extension, Instant Win, Interactive, Branded, Probability and Monitor games. And, we are not done yet. Some of the better known implementations from these categories include the Match 6 game in Pennsylvania, Mix & Match in Indiana, Multi-Win Lotto in Delaware, Add-A-Play and Palmetto Cash 5 in South Carolina, Triple Play and Add-A-Play in Tri-State (Maine, Vermont and New Hampshire), just to name a few.

PJ: *Is it difficult to enhance entertainment value while staying compliant with regulations?*

LW: For many reasons, it is true that traditional on-line lottery games historically have been less entertaining than skill based games and other games of chance. The reasons include:

- **Environment** – Although lottery products are carefully posi-

tioned as fun and entertaining, the traditional on-line distribution network is predominantly comprised of grocery and convenience stores, environments that, for the most part, are neither fun nor entertaining. One need only to look at the success of keno, Racetrax and video lottery to appreciate the magic that occurs when gaming products are available in places where people go to relax and have fun. As competition from other gaming venues continues to increase, it is crucial that lotteries expand their distribution networks into social environments. To this end, SGI is investing heavily in the development of a variety of entertaining monitor games tailored to these environments.

- **Instant tickets** enjoy many advantages over on-line products within traditional retail environments.
- **Availability** – Instant tickets are more accessible. Colorful banks of instant ticket dispensers at multiple registers effectively merchandise the games and often place them within arms reach. It is part of Scientific Games strategy to place on-line products “within arms reach” of consumers through a variety of mediums. In-store, this includes employing traditional as well as self-service terminals. The internet and mobile phones unquestionably offer much greater availability as proven by our European customers. In the near future, you will see more domestic lotteries use these technologies to reach new and existing customers in ways that are fully compliant with legal requirements.
- **Variety** – Instant tickets offer players a great variety of themes, prizes, price points and play methods, and rapid game turnover provides a sense of freshness for players and retailers alike. There’s always something new to look for. In contrast, traditional on-line games tend to be static. They are introduced far less frequently, and unless there is an unusually large jackpot, there is little spontaneity or urgency to make a purchase. This is another reason Scientific Games has expanded the online portfolio to provide players with new games that entertain and offer variety, as well as provide instant gratification. Our years as a leader in instant game design has enabled us to apply this know-how to on-line game design.
- **Infrastructure/culture** – Lotteries are designed to accommodate instant games, their most labor intensive product. Creating new games, managing the mix, managing retailers, warehousing and distributing tickets, processing returns, refreshing point-of-sale materials and installing ticket dispensers are never ending challenges that require a well trained sales force. As a result, lotteries have a very real sense of control – that they can directly and positively impact sales. On-line products do not provide the same sense of control. Although lotteries are involved in the design of on-line games, the slow rate of change limits their ability to influence sales especially on a short-term basis. A current exception appears to be the new found popularity of Raffle games in which lotteries can create exciting marketing events designed to satisfy

strategic needs. It is our plan to continue developing additional content that further taps into this type of consumer demand.

What traditional on-line games do best – better than any other gaming venue anywhere – is offer \$300 million prizes for just one dollar. Players expect this and have become spoiled - as have we. In many ways, we are victims of our own success, and though it is difficult to imagine new on-line games that are not jackpot driven, it is not impossible. While some new games may indeed require going “outside of the box,” we also believe viable new games also exist well within the box.

PJ: *How do SGI game development initiatives deal with those challenges?*

LW: Although skill based games can add a dimension not currently available to lotteries, random based games such as keno, Racetrax and video lottery are also capable of delivering large doses of entertainment. However, transitioning from a mega-jackpot mentality to an entertainment mentality will require some out-of-the-box thinking by vendors and lotteries alike. Together we must be:

- Willing to implement premium priced games;
- Willing to feature higher-than-normal prize payouts;
- Willing to penetrate new and perhaps non-traditional retail environments e.g. social environments, internet, etc.
- Willing to accept a controlled and reasonable level of risk with new game concepts;
- Willing to increase the number of games in the on-line mix, i.e. do not necessarily pull one game to make room for another
- Willing to nurture new games and educate players;
- Willing to modify or enhance new games if necessary; and
- Willing to compensate vendors and/or third parties for creative new and/or proprietary game content.

Many of these steps have already begun. We are beginning to see some premium priced on-line games with higher payouts (up to 65 percent in some cases). To complement higher payouts and price points, Scientific Games’ game development team is dedicated to enhancing the entertainment value of those games. We have found that even without the application of skill, it is entirely possible to create new play actions and game designs that deliver a great playing experience. Given the implementation of \$20 on-line Raffle games, we believe the future will include higher price-points, payouts, and unique game designs.

PJ: *Is the Racetrax monitor game a result of the Game Generation Incubator?*

LW: While Racetrax is a third-party product, the idea of offering multiple types of monitor games in a social environment is one that was born out of our SG3 process. Racetrax provides a terrific product solution to the idea of a “Racing Channel,” in addition to a “Keno Channel,” in social venues.

PJ: *How is this content and the way it is distributed new, different, and important?*

LW: Racetrax and keno tickets are sold at the same terminal. The Racetrax game is displayed on one monitor and keno on a separate monitor. Players can watch animated horseraces or keno drawings or both. The distribution of this content is important. We focus on utilizing effective technology that allows for quick distribution of new monitor games as well as other important game content.

PJ: *Is there anything you can tell us about the future of monitor games, either in general or SGI's plans?*

LW: Scientific Games will be implementing, together with our customers, a variety of other monitor game channels. In the near future we will launch games like Hold Em Poker as well as branded monitor games. With our strong licensed property portfolio, we can provide lotteries with new and exciting content for the monitor game environment.

PJ: *You've said, "...to grow the on-line market, lotteries must step outside the traditional on-line product game mix." Is it possible to be more specific about what is meant by that?*

LW: As mentioned, we and our customers must embrace bold, new game initiatives that will keep players interested. To do so means implementing new, perhaps non-traditional products that offer variety and deliver good winning experiences.

PJ: *What kinds of new games?*

LW: Our game portfolio offers players unique new play styles, new mediums, and prizes they will "talk" about. There is much more to come...stay tuned.

PJ: *It seems like RFP's over-value attributes that don't differentiate the bidders. Any suggestions as to how to improve the way the real drivers of lottery success are measured and can thereby be built into the RFP?*

LW: Looking at the industry, it does not take long to appreciate that the method for selecting major vendors places more value on the price of the service than the significant revenue generation from sales. One need only look at the result. Over the last ten years are there more vendors or fewer? Is there significant innovation? Have we well observed and discussed industry opportunities been aggressively developed? Have RFP's called for vendor investment in new distribution channels, new games and new products, and more importantly, provided scoring that reflects the significance of these investments? Industry consolidation and limited development are the attributes of a mature commodity based industry. Vendors will invest when the return on investment is promising. Unfortunately, government RFP's do not encourage this. In recent years, improvements in vendor returns have occurred primarily as a result of cost reductions and these savings have been passed on to lotteries in the form of lower prices. This

is the result of a process that was designed to procure equipment versus revenue generating goods and services.

The solution is actually quite simple. The evaluation of the vendor must include the dollar value of the potential revenues generated from products and services. This captures the total value to the state. Revenue value minus price equals net revenue value to the state.

PJ: *Along the same lines, how do you measure (in an RFP) the ability of the vendor to engender that spirit of collaboration and partnership between lottery and vendor that is so critical to operational success?*

LW: I think a track record of sales performance is as effective measure as any. For example, our full service CSP accounts rank in the highest growth in revenue year after year. This is the result of a strong partnership and a focus on the full potential of the business.

PJ: *How can the anxiety that retailers feel about alternative distribution channels (mobile, internet, etc.) be defused?*

LW: Through the effective use of technology as a delivery solution, we believe it is possible to keep retailers involved in the transaction so they retain their participation in game sales. Implementation of the right solutions to do this will require a strong partnership with lotteries and retailers alike.

PJ: *Tell us about Global Draw.*

LW: Global Draw operates a wide area gaming network of approximately 9000 gaming machines located in approximately 3000 licensed betting shops in the UK. The machines are linked via a satellite network which both "centrally determines" the outcome of each play cycle, and "downloads" new content into the machines as appropriate. Global Draw owns the entire system including the machines and the network, provides onsite maintenance, and develops proprietary content, and is compensated on the basis of a percentage of the machine "win". We believe that wide area gaming networks of this type will be one of the fastest growing segments of the gaming industry going forward, and that within this market, government sponsored gaming will be particularly important.

PJ: *Are there any other SG/MDI initiatives that you are able to tell us about?*

LW: One of the prime initiatives that we are working on is the development of handheld electronic games, such as Electronic Game Card, which has been successfully introduced in Iowa and Kansas. We have come up with two complementary products, PushPlay and the Electronic Scratch Ticket that enables these handheld games to be recharged by inserting a paper ticket using conductive ink to activate the electronics in the card. We feel that this can be an important new category of lottery games.

We have numerous other products under development as lotteries seek to keep their product line fresh and attract new players in social settings. ♣