

2008-2011



COMPREHENSIVE

BUSINESS PLAN



**Texas Lottery
Commission**

Drawings
Studio

FOR FISCAL YEARS 2008-2011

TEXAS LOTTERY COMMISSION

Comprehensive Business Plan

Fiscal Years 2008-2011

TEXAS LOTTERY COMMISSION

Comprehensive Business Plan

Fiscal Years 2008-2011

Foreword

This document, the Texas Lottery Commission Comprehensive Business Plan for fiscal years 2008 – 2011, was prepared by the management of the agency, inclusive of 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.

The Texas Lottery Commission published its first Comprehensive Business Plan in November 2004, which covered fiscal years 2005 – 2007.

This document is the culmination of a collaborative planning process that spanned several months and involved staff from all areas of the organization, including the commissioners, senior and middle management, and designated staff liaisons with responsibility for providing content from their respective divisions.

The planning process began in June 2007 when the Deputy Executive Director designated the Administration Division's Publications and Graphics Coordinator as project manager for the development of the plan. The project manager subsequently developed a detailed work plan and

timeline, and identified a project liaison in each division, in order to launch the project agency wide.

Throughout the process, the business plan content was developed collaboratively through meetings that were convened as part of the business planning process; through smaller working groups focusing on and refining particular areas of expertise; and through the sharing of completed drafts with executive management and the Commission.

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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 compliment that process and, along with other planning documents and management tools, provide a map for the agency for the three-year horizon covering fiscal years (FY) 2008 through 2011.

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 Commission, on the lottery side, is charged with generating revenue for the state of Texas while regulating those locations licensed 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 that statutorily limits the Commission from adopting strategies and action plans that would promote consumer participation in bingo play. Accordingly, this document actually contains two separate business plans under one cover—one for the operation of the Texas Lottery and one for the Charitable Bingo Operations Division.

Texas Lottery – *Supporting Texas Education*

After more than 15 years of operations, millions of players continue to enjoy the games of the Texas Lottery every day. In fact, Texas now boasts the 4th largest lottery in North America. But the Texas Lottery is not just about fun and games. The most important function of the Texas Lottery, by far, is to generate revenue for the Foundation School Fund, which helps pay for public education in our state.

The Texas Lottery supports Texas Education. It's not just a slogan; since 1997, all Texas Lottery proceeds – totaling over \$10 billion – have been transferred to the Foundation School Fund. In all, the Texas Lottery has generated more than \$15 billion for the state of Texas since the first ticket was sold in 1992.

Through FY 2007, the *Games of Texas* remain extremely popular with Texas Lottery players and the agency's annual transfers to the Foundation School Fund have totaled \$1 billion or more for four 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 must be 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. Therefore, this document lays out initiatives carefully designed to ensure continued maximum revenue generation for the Foundation School Fund in FY 2008 through 2011.

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, 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 2006, charitable bingo distributions exceed \$844 million. Total prizes paid out to players in 2006 exceeded \$491.7 million—the highest in the history of charitable bingo in Texas. Gross receipts

and charitable distributions have increased yearly since 2002, which is attributable to pull-tab sales. In 2006, pull-tab sales surpassed card sales for the first time. While gross receipts and charitable distributions have been increasing, we continue to see a decline in overall attendance at bingo games.

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 a quarter of a century, 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.

Customers and Beneficiaries

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, vendors, the Texas Lottery Commissioners and agency staff. Indirect customers are those Texas populations 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.

Direct Customers

Lottery Players

The Texas Lottery player base consists of adult Texans 18 years and older, as well as similar-aged visitors to the state who purchase Texas Lottery tickets.

Lottery Retailers

As of August 2007, the Texas Lottery had more than 16,000 licensed retailers. The two largest groups, according to Standard Industrial Code (SIC) statistics, are convenience stores with gas, and grocery stores.

Other Direct Customers

Additional direct customers of the agency include the three-member Commission and agency staff. In addition, the agency's Governmental Affairs Division serves as a resource to state leadership, other state agencies, and lawmakers considering legislation that would have an impact on the agency.

Indirect Customers

Texas Citizens

Texas citizens derive great benefit from the creation of jobs resulting from the conduct of the *Games of Texas*. Texas families also benefit from the Texas Lottery's revenue contributions to the Foundation School Fund, which supports public education in our state. The Texas Lottery has generated more than \$15 billion for the State of Texas since the first ticket was sold in 1992. Prior to 1997, the proceeds were allocated to the General Revenue Fund. Since 1997, all Texas Lottery proceeds, totaling more than \$10 billion, have been transferred to the Foundation School Fund. Other Texas Lottery funds such as unclaimed prizes revert back to the state for programs authorized by the Texas Legislature.

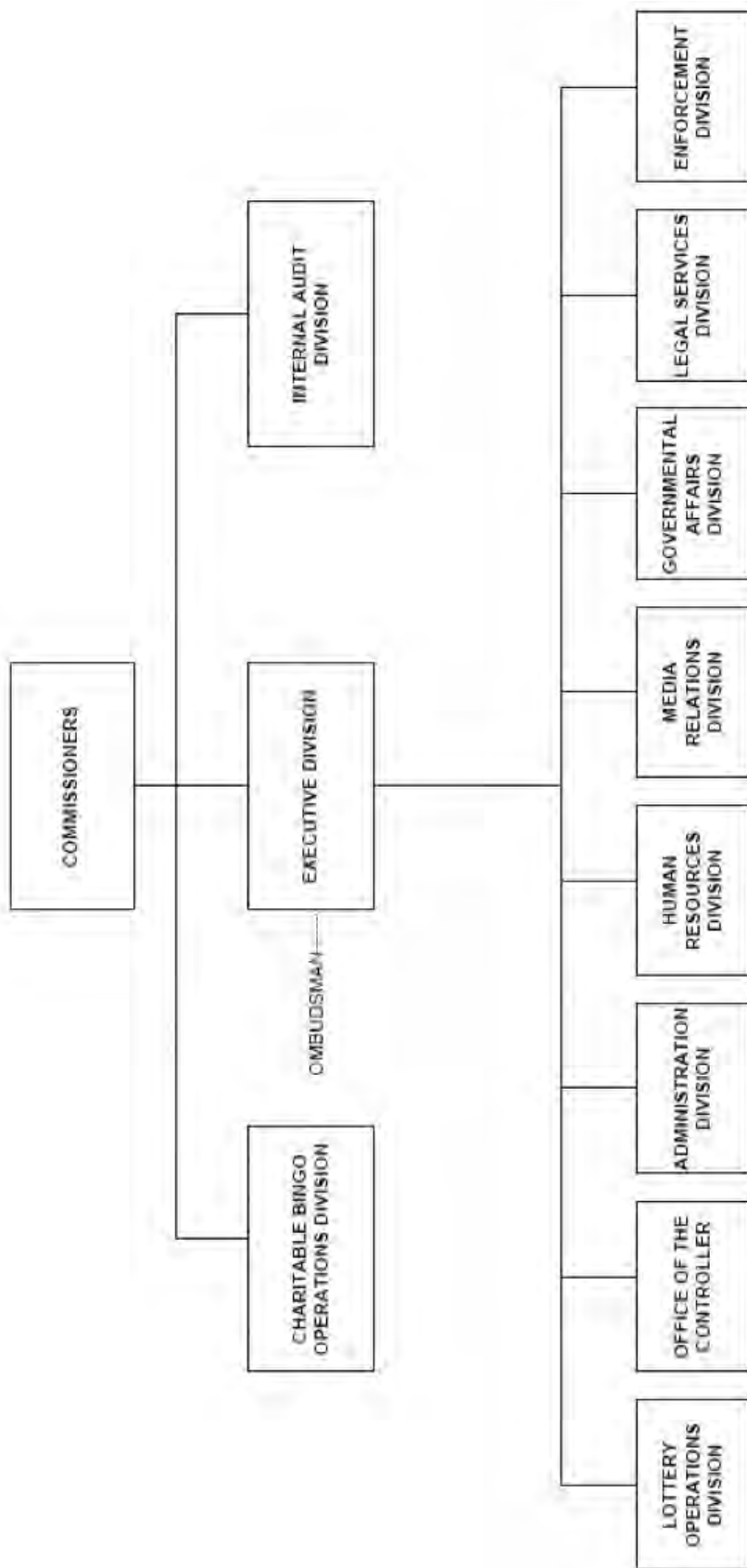
Management and Organizational Structure

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, thus shifting 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 maintains contractual arrangements with five 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.

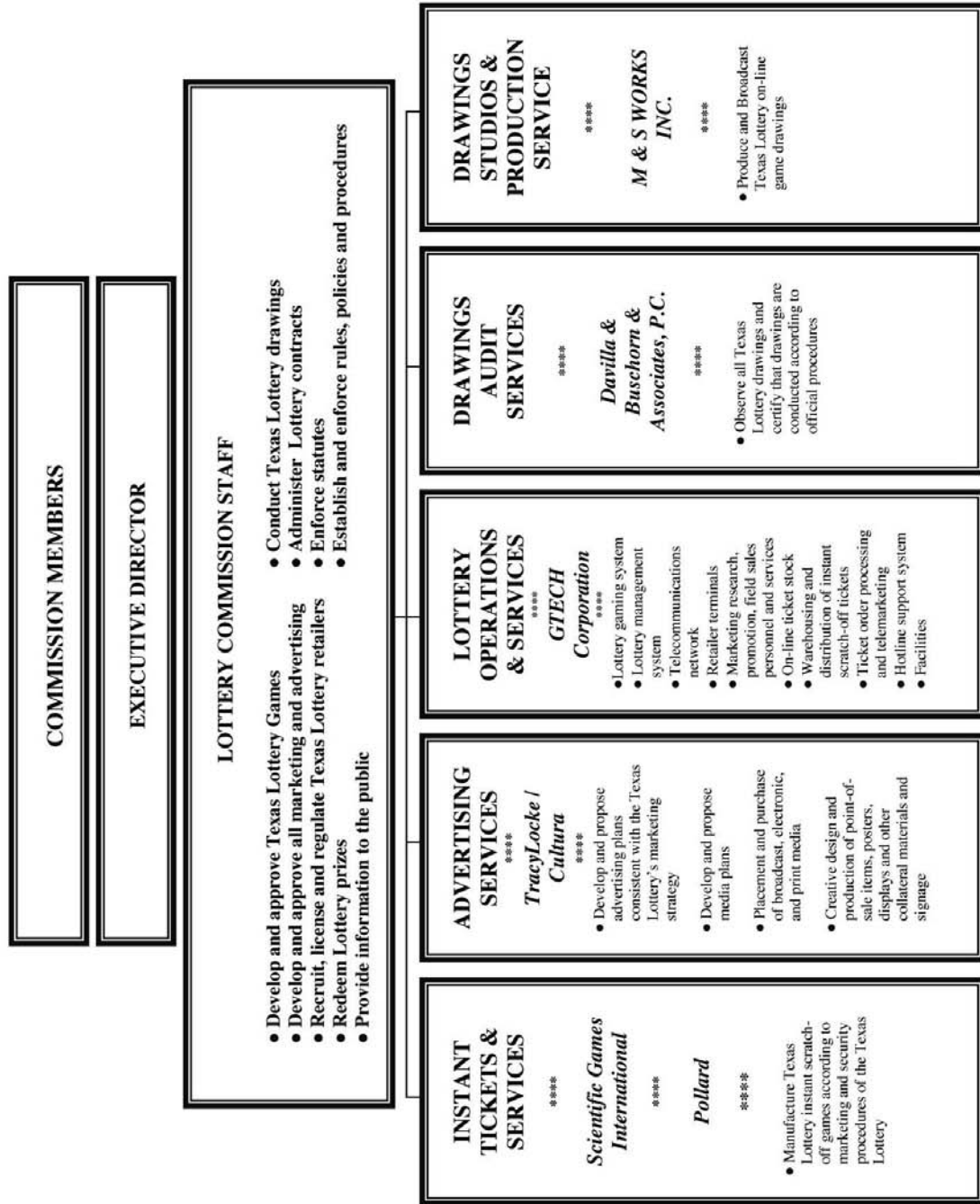
The three-member Texas Lottery Commission sets policy, promulgates rules for the agency, and performs all other duties required by law. The Governor appoints Commission members, with the advice and consent of the state Senate, to staggered six-year terms. One Commission member must have experience in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

The agency is divided into 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 on the next page.

Texas Lottery Commission Organizational Chart (Chart A)



OVERVIEW OF PUBLIC-PRIVATE “TEXAS MODEL” CONCEPT (Chart B)



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 2008 – 2009 biennium, House Bill (HB) 1 established appropriations for the General Revenue Dedicated Lottery Account in the amount of \$194.7 million in FY 2008 and \$195.5 million in FY 2009 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 2008		FY 2009	
	\$	%	\$	%
Lottery Operations	\$ 7.3	3.7%	\$ 7.4	3.8%
Lottery Field Operations	2.2	1.1%	2.2	1.1%
Marketing and Promotion	5.6	2.9%	5.6	2.8%
Security	4.4	2.3%	3.9	2.0%
Central Administration	10.6	5.4%	10.4	5.3%
Lottery Operator Contract	106.2	54.6%	108.1	55.3%
Instant Ticket Production Contract	19.2	9.9%	19.2	9.8%
Mass Media Advertising Contracts	32.0	16.4%	32.0	16.4%
Instant Ticket Vending Machine Contract	0.3	0.2%	-	0.0%
Drawing and Broadcast Contract	1.6	0.8%	1.6	0.8%
Market Research Contract	1.0	0.5%	1.0	0.5%
Retailer Bonus	4.2	2.2%	4.2	2.1%
Total	\$ 194.7	100.0%	\$ 195.5	100.0%

Sales

Sales for FY 2007 were just over \$3.77 billion and 2008 is projected at \$3.70 billion. Total sales for FY 2006 were a record-setting \$3.78 billion, marking the highest level of total sales in the history of the Texas Lottery Commission. While proud of those results, the agency recognizes

this kind of growth is likely to be unsustainable 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 gambling 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. In May 2007, the first \$50 instant ticket was introduced and the popularity of the game made an impressive impact to FY 2007 sales. In September 2007, the Commission launched the new online game *Daily 4™* with the add-on feature *Sum It Up™*. In November 2007, the same new add-on feature *Sum It Up* was added to the popular *Pick 3™* game. The agency expects these introductions to enhance on-line sales in FY 2008.

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

Contemporary lotteries in the United States have expanded to 42 states, plus Washington D.C., since New Hampshire's 1964 inception. The most recent lottery start-ups were Oklahoma in 2005 and North Carolina in 2006. The Texas Lottery finds itself situated in a mature market where it competes primarily for the discretionary 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 while simultaneously optimizing contributions to the Foundation School Fund, its primary beneficiary. This means working to develop games and strategies that appeal to players, legislators, and the general public.

Historically, the Texas Lottery has consistently ranked among the top selling lotteries in the United States. In recent history, Texas ranked among the top five U.S. lotteries in terms of total lottery sales, most recently ranking fourth and exceeded only by Massachusetts, New York and Florida.¹

The *Games of Texas* are the body of games that the Texas Lottery makes available to the playing public. These include instant games and on-line games. As of September 2007, six on-line games and approximately 100 instant games constituted the current game portfolio.

Instant Games

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” whether or not a prize may be claimed. Instant tickets include a variety of

¹ *LaFluer's 2007 World Lottery Almanac*. 2007. 15th edition. Edited by Teresa La Fleur and Bruce La Fleur. Boyds, Maryland: TLF publications. P. 317-318.

themes, play styles and prize structures in order to offer an attractive game mix to each of the player segments.

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

The Texas Lottery continues to follow a very aggressive game-launch strategy. In the late 1990’s, approximately 25-30 games were introduced in a fiscal year. By FY 2004, approximately 88 games constituted the game plan and in fiscal years 2006 and 2007, approximately 100 games were introduced each year. Introducing more games at smaller print runs keeps the product line new, fresh and exciting. In addition to the game launch strategy, higher price point games such as the \$30 and \$50 games have allowed the agency to reach impressive sales levels. Instant games are currently available at the following price points: \$1, \$2, \$3, \$5, \$7, \$10, \$20, \$25, \$30 and \$50. The concept of introducing multiple instant games at various price points on a frequent basis has allowed the agency to realize more than \$2.7 billion in instant ticket sales in FY 2005 and more than \$2.8 billion in 2006 and 2007.

Prizes for current instant games range from \$1 to \$5 million. Game themes include gaming, money, numbers, seasonal annuity and extended play. Licensed property games have also helped serve a niche by capitalizing on well-known, branded concepts such as the *World Poker Tour*®, *I Love Lucy*® and *Deal or No Deal*™. Licensed property games also provide an opportunity for members of the public who might not typically purchase a lottery ticket to do so, because of their familiarity with the branded property. The agency has also developed “core” games, those games that are always available for sale due to their ongoing popularity with players.

New to the Texas Lottery Commission for the 2008 – 2009 biennium is Rider 14 in the General Appropriations Act. This rider appropriates an additional \$3 million to the Instant Ticket Production Contract strategy, increasing this strategy from \$16.2 million to \$19.2 million per year. These additional funds were contingent upon the Commission adopting rules governing

instant ticket games that 1) close games after the final top advertised prize in the game has been claimed, and 2) provide procedures for ending the sale of an instant ticket game within 45 days of the game being closed. The Commission adopted new rules in compliance with this rider on June 10, 2007.

On-Line Games

On-line games are those games in which tickets are generated from a terminal connected to a central system. The terminal in the retailer location is said to be on-line with the lottery operator's central computer system. The Texas Lottery conducts game drawings to determine a set of winning numbers for these games. The agency's current on-line game portfolio is comprised of six games: *Lotto Texas*[®], *Pick 3*, *Cash Five*[®], *Texas Two Step*[®] and *Mega Millions*[®] with the Megaplier[®] feature. The Texas Lottery's newest game, *Daily 4* with the add-on feature, *Sum It Up*, was launched on September 30, 2007. *Sum It Up* was also added to the *Pick 3* game in November 2007.

Lotto Texas and *Mega Millions* are multi-million 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 game is drawn twice per week. In October 2003, Texas joined the multi-state game *Mega Millions* and sales started on December 3, 2003. The game matrix changed in the summer of 2005 as a result of the California Lottery's introduction into the game. Currently, the *Mega Millions* starting jackpot is \$12 million and numbers are drawn twice per week. Twelve member states participate in the *Mega Millions* game at this time. Texas is the only state to offer an add-on game, Megaplier, to the *Mega Millions* game. For an extra wager, Megaplier allows players the chance to increase their non-jackpot prize winnings. Games like *Mega Millions* are capable of generating jackpots upwards of \$300 million and, as a result, 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 large jackpot style games to reach large jackpot amounts in an effort to increase

sales. However, due to jackpot fatigue and the general declining interest in jackpot games, sales and revenue for this type of on-line game have generally decreased over time.

Texas Two Step is a rolling jackpot style game similar to *Lotto Texas* and *Mega Millions* 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.

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.

Pick 3 is a non-jackpot game and is the only game in the Texas Lottery’s game portfolio, both on-line and instant, to realize a sales increase every year since its inception in October 1993. The only change made to *Pick 3* in its 14-year existence was the addition of day drawings in April 2002. *Pick 3* is drawn two times per day, six days per week and is currently the best selling on-line game, illustrating that non-jackpot style games can be effective in reaching sales and revenue goals.

Daily 4 is similar in play style to *Pick 3*. However, it does offer a new play style, pair play, which allows players to wager on the first two, middle two or last two numbers drawn. Pair play is not offered on *Pick 3* and this will differentiate *Daily 4* from *Pick 3*. *Sum It Up* is a new add-on game concept. If the sum of the player’s numbers is the same as the sum of the four numbers drawn by the lottery, the player wins. This provides players a chance to win even if they don’t win on the base game. In order 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 in November 2007.

Challenges and Opportunities

Recent game innovations introduced in the United States include raffles, subscription services and increased instant ticket price points.

Raffles – At least 19 states have implemented raffle games since 2006, and Texas is currently considering a raffle-style on-line game.² Michigan, New York, Ohio and Pennsylvania have reissued their raffle games at least once. The agency has a pending request for opinion with the Office of the Attorney General regarding the legality of raffle games in Texas.

Subscription services – Illinois, Maine, Maryland, New Hampshire, New York, North Dakota, Vermont and Virginia offer subscription services for one or more on-line games.

Increased instant ticket price points – Most lottery states have now implemented instant ticket games at higher prices points including \$10, \$20 and \$25. In May 2007, the Texas Lottery was the first U.S. jurisdiction to introduce a \$50 instant ticket.

Additional trends in the lottery industry include the offering of video lottery (offered by six states), and Keno (13 states). Lottery sales via the Internet are also being considered in several states. In the 79th Legislature, Regular Session, HB 3343 and proposed House floor amendment to HB 3540 relating to an Internet lottery were voted down by the Legislature.³ Survey data suggest that more than 45 percent of the U.S. public would purchase lottery tickets online if they were made available.⁴ However, interest among Texans was lower (35 percent).

² *Lottery Insights*. 2007. "Recent Raffle Games." 8:32.

³ Hughes, Polly R. and Jeffrey Gilbert. 2005. "Internet lottery bill defeated in House / Debate sparks passion, unusual bipartisan alliance." *Houston Chronicle*. Section B, p. 4.

⁴ Hisrich, Robert and Bryan Axmear. 2006. "Internet Lottery Survey: A Look into Our Future." Glendale, AZ: Thunderbird School of Global Management.

During the 80th Legislature, numerous bills were introduced which, if passed, would have affected the Texas Lottery Commission, including:

- HB 1405, HB 3326, HB 3335, and HB 3351, which would have authorized video lottery terminals (VLTs);
- HB 3186 and SB 1478, which would have authorized and regulated poker gaming;
- HB 2739, which would have allowed the sale of lottery products at locations where alcohol was sold for on-premises consumption; and
- HB 3914 and SB 1751, which would have authorized (at least at the state level) the sale of lottery products through the Internet.

None of these bills were passed.

Lotteries nationwide are attempting to increase on-line game sales due to the higher profit margins of their traditional prize structures. However, on-line games are the “invisible” lottery product, as they do not have the visibility at the retail sales counter that the instant product does. As a result, on-line games rely more heavily on advertising to let the public know they are available and games with rolling jackpots require advertising to let the public know the current jackpot amount.

On-line game changes, supported by advertising dollars to promote the game change, often yield positive sales results. However, on-line game changes typically serve only to extend the traditional product life cycle. New on-line games or game changes also require extensive system programming time. These challenges, along with the agency’s formal rulemaking process (which, at a minimum, takes 90 -120 days) as well as advertising restrictions, limit the number of game introductions and enhancements that can occur on an annual basis.

The Texas Lottery’s instant game schedule of more than 100 new game launches per year, while successful, places an increased inventory management responsibility on retailers and any additional increases in game launches would need to be carefully evaluated.

Key Initiatives

In order to compete in a fast-paced, continuously changing marketplace, the Texas Lottery must continue to keep its product portfolio fresh and exciting by bringing new products to market and enhancing existing products. This approach allows the agency to continue to maintain sales levels and generate revenue for public education.

New Game Introductions and Enhancements Currently Under Consideration

The Texas Lottery is actively researching various aspects of its instant product portfolio, including the evaluation of higher price point instant games, expanding the base of core games to include higher price points, new licensed property games and “mega” games, which are typically higher price point games with very large print quantities. The higher price point coupled with the increased print quantity combines to form a “mega” prize fund that can allow for numerous high-tier prizes. A large number of high-tier prizes available in a game is appealing to players and is typically used to create “call-outs” (e.g., “Twenty \$1 Million Prizes Available in this Game!”) which are printed on the front of the ticket. All of these initiatives are being considered as possible enhancements to the instant product line. The recent successful introduction of the first \$50 scratch-off instant ticket in the country clearly shows that the Texas Lottery is a leader in product innovation.

The Texas Lottery is also considering and researching the following on-line game enhancements and/or new on-line games:

- ***Lotto Texas*** – the addition of a new prize level, match 2 numbers out of 6. The prize being considered for this tier is a free *Lotto Texas* ticket for the next drawing.
- **Raffle style game** – a short-term promotional game with a defined start and end date and a limited number of tickets sold for a specific draw date. (Note: The agency has a

pending request for opinion with the Office of the Attorney General regarding the legality of raffle games in Texas.)

- **Combo Purchases** – a way to market existing on-line games by selling products in packages.
- **Kicker/Spiel Feature** – an add-on game feature in which additional numbers are randomly selected and printed at the bottom of a player's on-line ticket. If the Kicker numbers match the winning numbers drawn, the player can win prizes based on how many numbers are matched.

Increased Price Points

The introduction of higher price point instant game products has increased variety in the instant product mix, as well as increased individual spend amount per purchase, resulting in increased sales and revenue.

The introduction of new price points in Texas has been a slow but steady progression. The first \$1 instant game was introduced in May 1992 and, most recently, the \$50 price point was launched in May 2007. As of September 2007, Texas was the only jurisdiction in North America offering a \$50 price point.

The \$50 price point was introduced only after considerable market research was conducted to determine if there was a market for this price point and to establish what the optimal ticket design and prize payout percentage should be. The agency is currently evaluating the sales and revenue impact from the introduction of the \$50 price point, and more time is needed before a decision is made on introducing a higher price point. However, the results indicate that the \$50 price point has been very positive in terms of sales and revenue.

The on-line product has only moved beyond the \$1 price point once in its history. In May 1998, *Texas Millions* was introduced at a \$2 price point. This game realized lower sales levels than

anticipated and the game was discontinued in May 2001, and replaced with *Texas Two Step*. The long-term industry practice of offering large, multi-million dollar top prizes at a \$1 price point limits the Texas Lottery's ability to upwardly adjust on-line price points.

The agency has experienced initial success in moving the price point for on-line games through the introduction of optional add-on features. The first such feature, Megaplier, was launched in connection with the *Mega Millions* game in December 2003. A significant number of *Mega Millions* players, almost 20 percent, regularly purchase Megaplier with their tickets, effectively moving the game to a \$2 price point. The Texas Lottery has recently introduced its second add-on feature, *Sum It Up*, with the launch of the new *Daily 4* on-line game in September 2007. The same add-on feature was added to the *Pick 3* game in November 2007.

The introduction of new price points throughout the history of the Texas Lottery has proven to be a successful strategy in maintaining interest in the games, being responsive to players' desires for higher price points, and ultimately increasing overall sales and revenue. However, 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. The introduction of higher price points can be viewed as an expansion of gaming. Appropriate market research, game introduction analysis, product development and player/public communication assist in addressing public concerns whenever new price points are considered. Additionally, careful planning and implementation of multiple price points are required to properly manage the overall prize payout percentage.

Prize Payout Percentage

Background

The prize payout percentage (the percentage of the total sales for the game that is allocated for prizes) for instant lottery games continues to be a key topic within the lottery industry. Higher prize payouts allow a larger prize fund, which can create more appealing prizes and better overall odds of winning any prize. Improved overall odds translate into more winning experiences for players, which typically yield higher sales. Conversely, higher prize payouts generate smaller profit margins and, therefore, an optimum percentage must be established to ensure maximum revenue generation for public education.

Market testing has shown that as the price point grows and the financial risk to the player simultaneously increases, there is a need for (and the player expects) more appealing prizes, increased gaming excitement and more frequent winning experiences. This is accomplished by increasing the prize payout percentage. This philosophy of increasing payouts as the price point increases, or as the financial risk increases for the player, is a basic risk-reward proposition. This model holds true for slot machines in the casino industry as well. As noted previously, on-line games are different in that a range of price points are not currently available. Most on-line games are only offered at the \$1 price point with a prize payout percentage of approximately 50 percent.

The prize payout percentages in Texas have remained relatively constant with one notable exception. The Legislature capped the prize payout percentage in the 75th legislative session. The Texas Lottery was required to decrease the overall prize payout percentage from 57 percent to 52.5 percent during fiscal years 1998 and 1999. The effect of the payout reduction was immediate and dramatic, resulting in a 23.6 percent decline in instant game sales and a 17.5 percent decrease in total sales for FY 1998. Instant game sales decreased another 22.1 percent in FY 1999. During the 76th legislative session, House Bill 844 removed the cap and that change took effect in June 1999. FY 2000 instant game sales rebounded, increasing 18.5 percent over FY 1999.

The table below illustrates the history of the instant game prize payout percentages at each available price point.

Price Point	Year Introduced	Introduction Payout	FY98 – FY99 Payout	Current Payout
\$1	1992	45% - 60%	50%	60%
\$2	1993	65%	55%	65%
\$3	1997	65%	58%	65%
\$5	1996	65%	60%	68% *
\$7	2002	65%	n/a	68% *
\$10	2000	70%	n/a	70%
\$20	2002	70%	n/a	72% **
\$25	2004	72.5%	n/a	72.5%
\$30	2004	72.5%	n/a	72.5%
\$50	2007	72.5%	n/a	72.5%

*In FY 2004, the agency raised the prize payout percentage for the \$5 and \$7 price points from 65 percent to 68 percent. A 41-percent sales increase (year over year) was realized in the \$5 price point after that increase.

** The first three \$20 games in 2002 and 2003 were introduced at a 70-percent prize payout; subsequently the prize payout percentage was increased to its current level of 72 percent.

Challenges and Opportunities

Even though the prize payout percentage cap has been removed, the Texas Lottery still has limitations on prize payouts. Statutory restrictions result in an inverse relationship between the agency's overall prize payout percentage and its advertising budget. The General Appropriations Act provided \$32 million per year for lottery advertising for the FY 2008 – 09 biennium. However, the net effect of these restrictions has lowered the agency's advertising budget to \$31 million in FY 2008. Similar budgetary limitations are anticipated in FY 2009.

While significant changes to the instant and on-line game payout percentages have not occurred in recent years, the Texas Lottery has experienced an increase in the overall prize payout percentage for all games. This can be attributed to a continued decline in overall on-line product

sales and an increase in overall instant product sales. During fiscal years 2005 and 2006, instant games accounted for approximately 74 percent and 76 percent respectively. Since instant games historically have a higher prize payout than on-line games and make up a greater share of the agency's total sales, the result is an increase in payout overall. In order to strike a balance and not have the overall payout increase dramatically, on-line games continue to be produced at an approximate 50-percent payout. This limits the agency's ability to create on-line games with higher payouts and reap the benefits realized from larger game prize pools without adversely affecting the agency's advertising budget.

Key Initiatives

Legislation would be required to remove the link between the agency's advertising budget and the overall prize payout percentage. The Texas Lottery has used other means to create winning experiences for players with existing prize payout levels in order to mitigate the impact on the advertising budget. For example, the number of consecutive non-winning tickets in instant games has been reduced. Staff is also considering additional game changes that will add prize tiers and reduce the overall odds of winning.

Distribution Channels

Background

Increasing not only the number of locations, but also the variety of trade styles where Texas Lottery products are sold provides more convenient access for current and potential customers, thus increasing sales opportunities. Growing the player base involves expanding into new sales venues outside of traditional lottery retail locations as a means of reaching new players. While the Texas Lottery works to support existing licensees, identifying potential player segments and recruiting new trade styles can contribute to a stable and growing product distribution channel.

Retailer Trade Style Penetration in Texas

The number of retailers in the Texas Lottery sales base has remained fairly constant at approximately 16,000 licensees since 1992. Although the base contains a variety of trade styles, there has been a trend toward an increasing share of convenience stores and grocery stores as the primary trade segments. Together, these categories now comprise more than 91 percent of retailers and 96 percent of Texas Lottery sales.

The majority of Texas Lottery sales are generated through traditional clerk-assisted transactions at convenience stores. However, many retail venues are best suited for a player-controlled or self-service model due to multiple venue entrances and a variety of customer traffic patterns.

The Texas Lottery currently deploys two types of self-service lottery machines: 1) instant ticket vending machines (ITVMs) that dispense scratch tickets, and 2) self-service terminals (SSTs) that produce on-line game tickets and allow players to check their own tickets for winning status. By early 2008, the Texas Lottery will offer a third type of self-service terminal, GamePoint™ (also called Lottery to Go™), that offers combined instant and on-line game ticket sales as well as the ability for players to check their own tickets for winning status.

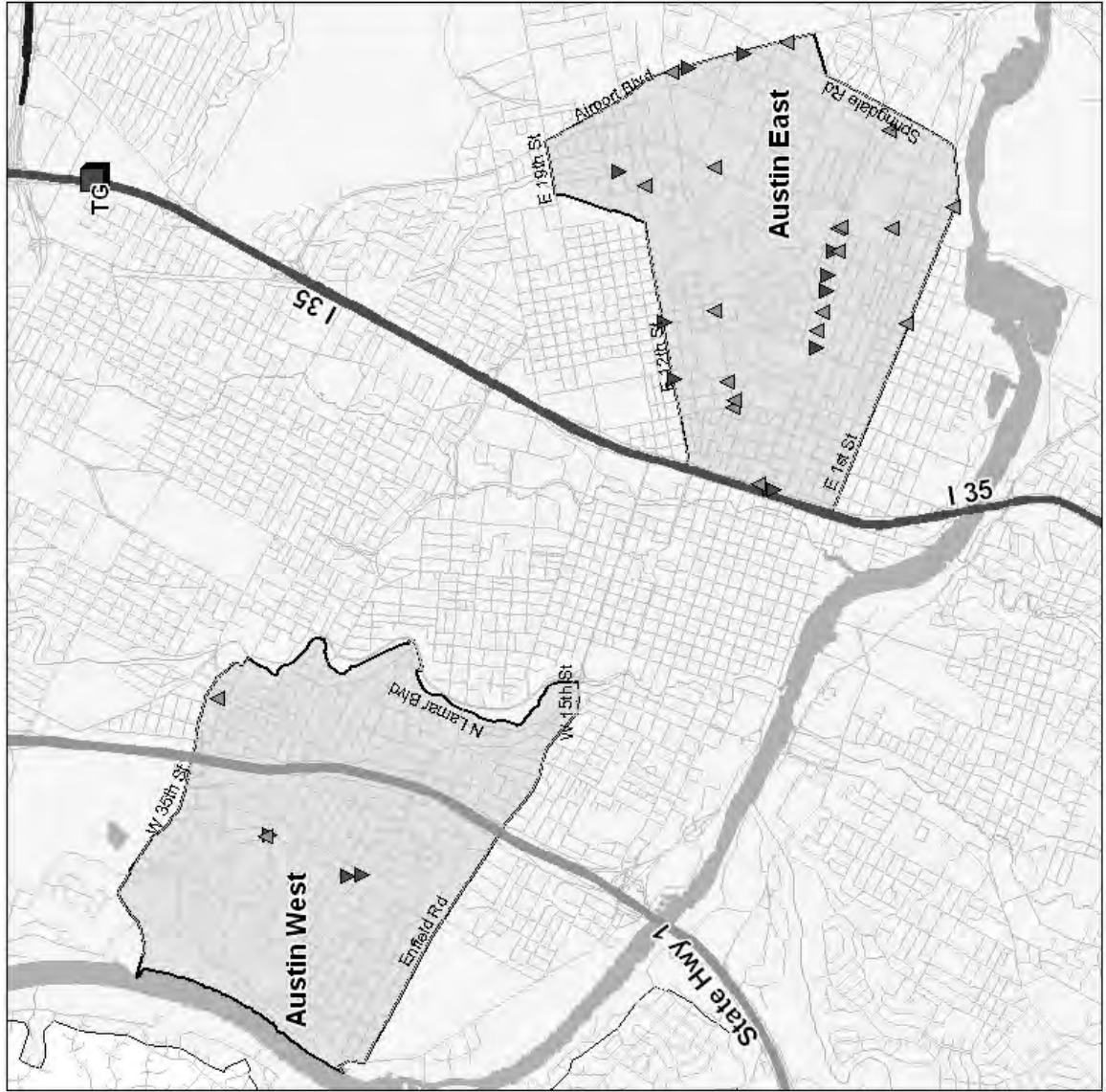
With the future deployment of approximately 10,000 Ticket-Scan[™] machines, players will be provided expanded access to the convenience and added security of checking their own tickets for winning status prior to validation by a retailer. This functionality currently is available on approximately 1,000 SSTs deployed across the state.

Challenges and Opportunities

There are several challenges in recruiting retailers who traditionally have not carried lottery products. Retailers are ultimately focused on offering products to their consumers that drive bottom-line profits in their stores. This focus typically translates into retailer emphasis on higher profit margin items. Lottery products are capable of contributing to bottom line margins. However, because lottery tickets produce lower profit margins than many other products, retailers' interest in lottery product offerings is limited. Lottery products, particularly instant tickets, can also present operational issues for the retailer. Key among them are inventory control and shrinkage concerns, back-office accounting challenges related to lottery products, and the potentially labor-intensive nature of requirements for licensing and sale of the product. Additionally, selling lottery products may not align with the retailer's corporate business strategy.

Retailer density in high-income census tracts can create challenges in reaching consumers in these areas. The maps on the following pages illustrate this challenge. The maps depict two areas of Austin, one affluent and the other less so. Current lottery retailers are plotted on the map for both areas. Also plotted on the maps are businesses such as convenience stores, groceries and package stores that are not currently licensed lottery retailers. The maps show that current lottery retailers are more numerous in the less affluent area. There are also more potential unlicensed retailers in the less affluent area. Overall, the maps show that there is a greater density of traditional lottery retail businesses in the less affluent area. One of the maps also shows the location of big box retailers in relation to the two areas detailed on the maps. The Texas Lottery has and will continue to recruit retailers in all areas where there are retail businesses that might be viable locations from which to sell lottery games.

MAP 1



- TEXAS LOTTERY RETAILER**

 - Convenience Store Chain
 - Gasoline Service Station
 - Grocery Stores
- NON-TEXAS LOTTERY RETAILER**

 - Convenience Store Chain
 - Gasoline Service Station
 - Grocery Stores
 - Liquor Stores

AUSTIN EAST		
Industry	Non-Texas Lottery Retailers	Existing Lottery Retailers
Convenience Store Chain	7	15
Gasoline Service Station		
Grocery Stores	1	3
Liquor Stores	3	
Total	11	18
AUSTIN WEST		
Convenience Store Chain		
Gasoline Service Station	2	
Grocery Stores		2
Liquor Stores	1	
Total	3	2

MAP 2



TEXAS LOTTERY RETAILER

NON-TEXAS LOTTERY RETAILER

- WM Wal-Mart
- SC Sam's Club
- TG Target
- HD Home Depot
- LW Lowes
- CC Costco

Key Initiatives

Traditionally in Texas and other states, “big box” retailers and general-merchandise retailers do not carry lottery products. The same is true for most national pharmacy chains. Recruitment efforts by the Texas Lottery, lottery operator and North American Association of State and Provincial Lotteries (NASPL) representatives have identified consistent challenges to recruiting national corporations representing new trade styles: deployment of self-service equipment, standardized licensing and accounting processes among all states, and implementation of new technologies providing back-office connectivity/interface.

Inherent in offering the sale of lottery tickets via self-service terminals is the challenge to effectively enforce age verification of players. Equipment currently being deployed by the Texas Lottery will have the technology and infrastructure necessary to conduct such age verification electronically in the future if approval is granted by the Commission and such approval is deemed to be within the Commission’s authority.

The Texas Lottery is working with NASPL and the Petroleum Convenience Alliance for Technology Standards (PCATS) to create standards for lotteries for use in 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.

Premium retail locations such as package (liquor) stores that focus on fine wine and spirits, gourmet food shops and cigar stores have not traditionally been a large part of the Texas Lottery’s or other states’ retail base. These retail trade styles typically have lower foot traffic than traditional lottery retailers such as convenience and grocery stores. However, buyer behaviors and average transaction price indicate this type of premium retailer could contribute to expanding distribution channels by providing convenience and access to a broader player base.

The agency is actively working with the lottery operator to enhance retailer recruitment efforts to increase the Texas Lottery’s overall presence in these types of businesses. Additional businesses of interest related to recruitment include shopping centers, airports and federal buildings. Lottery

sales are prohibited on land that is owned by the state of Texas where an agency of the state is located.

Advertising and Communications

Background

Advertising has a positive effect on Texas Lottery sales and, ultimately, contributions to the Foundation School Fund. A study conducted at the Texas Lottery's request by the McCombs School of Business at the University of Texas at Austin indicates that the agency's current advertising budget is under-leveraged. Academic studies of reductions in advertising expenditures in other lottery jurisdictions have resulted in a negative impact on sales and revenues.

Current Advertising

The agency makes considerable efforts to wisely allocate its advertising dollars and meet the objective of reaching the public to responsibly increase revenue and enhance awareness of Texas Lottery games. The Texas Lottery Commission's advertising is allocated between the 20 Designated Market Areas (DMAs) throughout the state, using a combination of mass media and point-of-sale materials.

Challenges and Opportunities

Shrinking Ad Dollars

Section 466.015(d) of the Texas Government Code provides that if the total amount of lottery prizes awarded by the Texas Lottery in any state fiscal year after the fiscal year ending August 31, 2000, exceeds an amount equal to 52 percent of the gross revenue from the sale of tickets in that fiscal year, the advertising budget for the lottery in the next state fiscal year may not exceed an amount equal to \$40 million less \$1 million for each full percent by which the total amount of lottery prizes awarded by the Texas Lottery in the preceding fiscal year exceeds an amount equal to 52 percent of the gross revenue from the sale of tickets in that preceding fiscal year. While the Texas Lottery's advertising budget has diminished each year, the actual cost of advertising has increased. An advertising budget of \$40 million in 1997 dollars would equate to \$50.3 million in 2006 dollars, adjusted for inflation. This exceeds the FY 2007 advertising budget of \$31 million by \$19.3 million. Adjusted for inflation, this legislation has effectively reduced the agency's advertising budget by 40 percent, resulting in a significant challenge for the agency to effectively market its products.

With a greatly expanded product mix, the agency faces significant challenges in advertising its products. In FY 1992, lottery products consisted of one on-line game (*Lotto Texas*) and two instant games. Today, the Texas Lottery offers six different on-line games and launches more than 100 instant games each year.

In FY 1992, players were easy to reach frequently via TV and radio advertising. The market has experienced dramatic media proliferation over the last few years with the expansion of Internet advertising, growth in cable channels, satellite TV and radio, and the emergence of technology such as TiVo® that can limit advertising exposure. These market trends mean it is becoming more difficult to reach large groups of consumers for the same level of media expenditures.

Since FY 1992, the population of Texans over 18 has increased by 47 percent from 12,564,393 to 18,500,000. The population is also more ethnically diverse with a majority minority population. The following chart provides a comparison of lottery advertising between 1993 and 2007.

TEXAS LOTTERY ADVERTISING OVERVIEW		
	1993	2007
Advertising Budget	\$40 million advertising budget	\$31 million advertising budget in today's dollars, which is of significantly lower value than the same amount in 1992 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"> • \$31 million advertising budget to 18.5 million Texans 18+
Number of Products	TWO <ul style="list-style-type: none"> • <i>Lotto Texas</i> • 2 Scratch-off Games 	SIX+ <ul style="list-style-type: none"> • <i>Lotto Texas</i> • Scratch-offs (approx. 100 launched annually) • <i>Pick 3</i> • <i>Cash Five</i> • <i>Texas Two Step</i> • <i>Mega Millions/Megaplier</i> • <i>Daily 4</i> (September 2007 launch) • Potential new game(s)
Product Life Cycle	Lottery product was brand-new, generating immense excitement and interest.	Lottery product is closer to maturity, creating the need to infuse excitement and interest via game changes, new features and new games

		(all which need to be communicated to the players).
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.	Texas population is more diverse with a majority minority population.
Media Proliferation	Players were easy to reach frequently via TV and radio advertising.	Satellite TV, Internet, TiVo, iPods® and satellite radio are prevalent, making it more challenging to reach players.
Pay at the Pump	Because pay-at-the-pump technology was new and limited, most people went into the store to pay for gas.	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.

Statutory Limitations on Types of Advertising

Statutory provisions also affect the type of advertising the agency can use. 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

Limiting the advertising budget based on the prize payout percentage inhibits the agency's ability to communicate effectively about its products in an effort to optimize sales and revenue. Removing this restriction would allow the agency the flexibility to utilize all appropriate funds and determine the optimal advertising budget for sales and revenue maximization. Additionally, a re-evaluation of the restrictions placed on the agency's advertising efforts would allow the

agency the flexibility to develop stronger creative messaging and more strategically purchase media to reach consumers.

The Texas Lottery continues to optimize the effectiveness of its advertising through continuous analysis and oversight of media buying, and creative development performed by the contracted advertising vendor. However, the agency continues to lose ground in reaching consumers due to limitations and restrictions on both the type and amount of its advertising expenditures. Without modifications or removal of these restrictions, the agency faces significant challenges in maintaining current levels of product awareness and continuing sales growth.

Hours of Operations for On-line Games

Background

Currently, on-line game tickets are available for sale daily from 6 a.m. through midnight. The terminals which generate on-line game tickets shut down at midnight and overnight processing takes place with the system going back on-line the next morning at 6 a.m. Scratch-off tickets are sold 24 hours a day because the terminals are not required to sell these tickets. The on-line system is required to validate all tickets, including scratch-offs, so scratch game validations cannot occur between midnight and 6 a.m., which also may dampen the appeal of scratch-off ticket purchases during the period when the system is off-line.

Challenges and Opportunities

Increasing the operating hours for on-line game sales would provide players more convenient access to the Texas Lottery's on-line products and, in doing so, provide an opportunity for increased revenue. As a mature lottery, the number of new product innovations for Texas that have potential impact on sales is limited and other means should be explored to increase product availability and revenue.

As work patterns have changed, many Texas Lottery licensed retail locations have expanded their hours of operation to 24 hours, and many other locations open well before 6 a.m. Extended operating hours have allowed these businesses to serve the needs of their customers that work third shifts or that have early-morning commutes. The current hours of the Texas Lottery gaming system do not allow retailers that are open for business during these early morning hours to offer on-line lottery products to their customers and, in addition, these retailers cannot validate or check to see if an instant ticket is a winner, limiting full-service support for the product. If the on-line system were available during this time, there is the potential for increased revenue for both Texas Lottery product lines.

Key Initiatives

The current off-line overnight processing period allows for the balancing of the previous day's sales data between the lottery operator and the Texas Lottery, and for the generation of required reports. However, system improvements that have occurred over time would now allow the six-hour processing window to be decreased significantly. Near 24-hour operation of the on-line lottery system is now possible. The Texas Lottery and the lottery operator would need to coordinate to optimize operational hours, while allowing sufficient off-line time to perform required reporting and balancing activities.

The expansion of the on-line system operating hours would require Commission approval. In addition, 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. The expansion of on-line gaming system operating hours could be viewed as an expansion of gaming, and appropriate research and communication with state leadership offices and the public would need to occur before any action is taken in this regard.

Internal Initiatives – Operational Support and Improvement

Electronic Records Management

Background

Technological advances in recent years have changed the way agencies do business. From business transactions to administrative functions, more and more business is being done electronically. Recent e-government legislation encourages agencies to use information technology to streamline processes, reduce paperwork, improve response time and provide better access to government services. For e-government to be sustained over time, electronic records must be managed consistently, preserved appropriately and easily accessible.

Challenges and Opportunities

The management of electronically generated records creates new and additional challenges for the agency. While electronic records are included in the statutory definition of a state record, clear guidelines and parameters must be established to assist divisions in identifying what type of electronic records need to be saved, what process or technology should be used for the preservation of the record and how those records will be retrieved.

Key Initiatives

Guidelines for Management of Electronic Records

An effective e-records management program will result in new policies and procedures that will provide for more efficient use of computer resources, more consistent management of e-records, proper and timely disposition of e-records that have served their purpose, and standard e-mail management policies.

The Texas Lottery will review state policies and procedures for managing electronic records and establish guidelines that identify what needs to be saved, how it will be saved, how it will be retrieved and how and when it will be destroyed. The Records Management Coordinator and Information Resources Department will develop standards for managing electronic records that include best mechanisms for data storage (i.e., network folders, email, applications such as CAMP, the document imaging system), ownership of records and standards for destruction (i.e., ensuring electronic records are destroyed when paper records are destroyed).

Expanding the Texas Lottery's Document Management System

The Texas Lottery successfully utilizes an e-records file management system for retailer licensee records and instant ticket working papers. This program has resulted in significantly reduced file-storage needs, enhanced access to file data by multiple e-records system users and more efficient records retention.

The Texas Lottery is committed to the expansion of e-records strategies based on the success of current initiatives. The Texas Lottery will continue to evaluate and prioritize new initiatives for the agency's document management center. The Information Resources Department will determine infrastructure needs based on the projects approved for implementation.

Business Continuity

Background

To support operations, the Texas Lottery has offices located throughout the state, which include the Austin headquarters facility and drawings studio, 16 field offices and warehouse facilities. Including the agency's headquarters facility and drawing studio, 11 (61 percent) of the agency's leases will expire by the end of calendar year 2010.

Challenges and Opportunities

All Texas Lottery field office leases are procured by the Texas Facilities Commission and Texas Lottery generally co-locates with other state agencies. Eight field office leases will expire by 2010, five of which have renewal options. The headquarters/drawing studio, warehouse and convention center parking leases were all procured by the Texas Lottery. All three leases will expire by 2010. The Commission has renewal options for the headquarters/drawing studio and convention center parking leases. There are no renewal options remaining on the warehouse lease, which is also the agency's disaster recovery site.

Key Initiatives

The Austin warehouse lease expires February 14, 2010. The agency will evaluate all options available, including possibly negotiating lease extensions. Staff will work with the Texas Facilities Commission to conduct rent surveys in the Austin area. A cost-benefit analysis will be prepared to help determine the best option available to the agency. If the best option identified is to relocate to a new facility, the agency will have to seek capital budget authority to cover the infrastructure costs associated with the disaster recovery activities.

Operational Continuity

Background

The Texas Lottery Commission currently has a single contract for the provision of lottery operations and services which support the agency's core business functions. The contract provides a variety of goods and services related to the administration and operation of the lottery. These include, but are not limited to: lottery gaming system operation and maintenance, telecommunications network, retailer terminals, sales, marketing/promotion, warehouse and distribution and a hotline support system. The current contract was awarded October 10, 2001, and expires August 31, 2011. The value of this 10-year contract is estimated to be more than \$1 billion.

Challenges and Opportunities

A number of options are available to the agency for the delivery of services set forth in the Lottery Operator contract. In October 2006, staff developed a document titled "Plan B" that provided the framework for analyzing and exploring these options. The recommendation was that the agency should immediately move to address two fundamental issues:

1. Business continuity for the services provided under the lottery operator contract.
2. The procurement strategy for the lottery operator contract upon its completion.

In addition to business continuity and procurement strategies, a third issue, compensation structure, was identified as needing review. Any procurement strategy should ensure the resulting compensation structure is fair, equitable and maximizes revenue to the state.

Key Initiatives

The Texas Lottery has issued a Request for Proposals for a consultant to provide expertise and assistance in analyzing and exploring options available for the delivery of core lottery business functions and developing the resulting procurement documentation. Under a contract resulting from the RFP, the following milestones have been identified:

1. Award consultant contract
2. Business operations process review
3. Business case development
4. Award Outside Counsel contract
5. Develop and issue procurement documents

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.

Customers, Beneficiaries and Partners

Customers

Customers of the CBOD are: licensed organizations including charitable organizations, 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. 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 2006, reported charitable distributions from bingo activities were \$31,869,748 while the minimum required charitable distributions for 2006 were \$10,217,853. Charitable distributions have increased each calendar year from 2003 through 2006.

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 city are both entitled to a share of the bingo prize fee, the county is entitled to 25 percent of the fee on a prize awarded at a game conducted in the county, and the city is entitled to 25 percent of the fee on a prize awarded at a game conducted in the municipality.

In 2006, counties received \$6,151,752 in allocations and municipalities received \$5,608,691 in allocations from the conduct of charitable bingo. Allocations to counties and municipalities have increased yearly from 2002 through 2006.

Partners

The CBOD partners with the Bingo Advisory Committee (BAC) in the regulation of charitable bingo activities. The purpose of the BAC is to: advise the Texas Lottery Commission on the needs and problems of the state's charitable bingo industry; comment on rules involving bingo during their development and before final adoption, unless an emergency requires immediate action by the Commission; report annually to the Commission on the committee's activities; and other duties as assigned. The BAC is composed of nine members to represent the following interest groups:

- (A) the public,
- (B) conductors that are not licensed commercial lessors,
- (C) conductors that are licensed commercial lessors,
- (D) commercial lessors, and
- (E) system service providers.

Appointments to the BAC are required to represent a balance of interest in the charitable bingo industry in Texas.

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, instant tickets and electronic card-minding devices, prior to sale, lease or use in Texas.

The CBOD is divided into departments that collectively regulate charitable bingo. Each department has a manager who reports to the director. The Compliance 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.

For the 2008 – 2009 biennium, House Bill 1 (HB 1) established appropriations for the General Revenue Account in the amount of \$15.2 million in FY 2008 and \$15.4 million in FY 2009 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 2008		FY 2009	
	\$	%	\$	%
Bingo Licensing	0.9	5.7 %	0.9	5.6 %
Bingo Education & Development	0.2	1.1 %	0.2	1.0 %
Bingo Law Compliance Field Operations	1.4	9.4 %	1.4	9.3 %
Bingo Prize Fee Collections & Accounting	0.2	1.3 %	0.2	1.3 %
Bingo Prize Fee Allocations	12.5	82.5 %	12.8	82.8 %
Total	\$ 15.2	100 %	\$ 15.4	100 %

Bingo Prize Fee Allocations make up approximately 83 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 \$11.8 million has been allocated back to local jurisdictions.

In calendar year 2006, gross receipts from charitable bingo totaled \$658 million, bingo prizes awarded were \$492 million, and charitable distributions totaled approximately \$32 million.

Planning for the Future

General Industry Environment Trends

Charitable bingo competes in a mature, yet dynamic 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 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 19.5 million in 2006.

Opportunities, Challenges and Risks

The emergence of the online gaming market and the expansion of gaming in neighboring states presents a challenge for the bingo division and the bingo industry in years 2008-2011. Additionally, smoking bans implemented in local jurisdictions in Texas may impact the future of 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 constituent 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 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 gaming 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 Web site. 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.

Webcasts and Podcasts

Webcasts and podcasts provide licensees and the general public with information in plain language relative to various aspects of charitable bingo in Texas. For example, one podcast provides guidance on applying for a temporary license which condenses the process into an easily understood format.

E-filing and Payment

This new initiative will result in streamlining the quarterly filing and paying process for licensees and the division by allowing a registered user to file quarterly reports, prize fee and tax payments or file an amendment to a previously filed quarterly report through the Web-based Bingo Services Center.

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.

Web-based Operator Training Program

Other organizations provide training via the Internet, which results in convenience to the end-users and cost savings to the agency. In general, the goal of Web-based training is to provide individuals the opportunity to complete the required training in a convenient manner.

The CBOD will investigate the cost benefit of developing the Web-based training. The Web-based training will be developed using internal resources, but may require nominal external costs for production.

Internal Initiatives – Operational Support and Improvement

Evaluating Organizational Structure and Responsibilities

The CBOD will continually evaluate work flow processes to maximize the efficient use of resources.

E-Records Management (i.e., TeamMate etc)

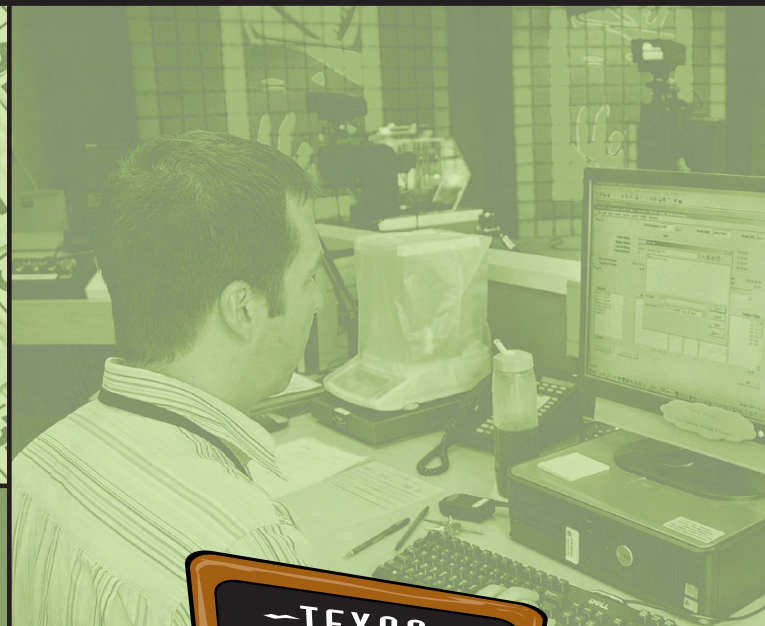
The CBOD will continue to develop requirements for implementing paperless activities. TeamMate, an automated work paper software application, will be utilized by the Compliance Department to reduce the amount of paper maintained by the division. This enhancement also provides open accessibility to all audit staff members.

Employee Communication

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



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