California Lottery

For 13 years, the California Lottery had the lowest instant prize payouts in the U.S. at 50%. During that period, it also consistently ranked near the bottom of all U.S. lotteries relative to instant per capita sales.

California's instant sales peaked in year one (1985) and steadily declined for the next six years. In 1992, the Lottery deployed Instant Ticket Vending Machines (ITVMs) and sales got a boost (prize payouts remained the same). Then, in 1996, ITVMs were pulled from the marketplace and sales sharply declined.

continued >>>
With instant sales once again on the decline, the California Lottery took action in FY98:

- *Raising its instant prize payouts from 50% to 60%*
- *Implementing full redemption (i.e., players could cash winning tickets at any CSL retail location, not just at the location from which they purchased the ticket)*
- *Reinstituting its ITVM program.*

The impact was immediate and positive:

*Only total return to the state available.*
Total Revenues to Education are as follows:
- FY98: $834.7 Million
- FY99: $899.3 Million
- FY00: $948.00 Million
- FY01: $1.111 Billion
- FY02: $1.064 Billion
- FY03: $1.019 Billion
- FY04: $1.094 Billion
- FY05: $1.175 Billion
- FY06: $1.287 Billion
- FY07: $1.206 Billion
- FY08: $1.093 Billion (unaudited)
Florida Lottery

Established in January 1988, the Florida Lottery had long watched other states effectively employ a higher prize payout strategy to increase lottery sales and net profits, but was prohibited itself from implementing a similar strategy.

Florida law mandated the Lottery return the following percentages to the state’s Education Enhancement Trust Fund (EETF):

  • 38% of instant ticket sales (January 1988 to June 2002)
  • 38% of online sales, which includes Florida Lotto, Fantasy 5, Cash 3 and Play 4
    (1988 until June 2003 and 39% of online sales since July 2003)

Florida law restricted prize payouts to 50% of sales. Unclaimed prize money was used to augment prize payouts above the 50% restricted level. This flexibility in using unclaimed prize money would remain in place until July 1, 2002.

And while the unclaimed prize money helped provide a measure of payout relief for the Lottery, it resulted in erratic payout levels which, according to Lottery officials, “put players’ trust at risk.” Eventually, the Lottery would turn to sales data from other U.S. jurisdictions to build its case for complete variable prize payout flexibility.

The Lottery’s case and the growing need for education funding was ultimately strong enough such that state law governing Lottery payouts was changed in July 2002, as reflected in this chart:

<table>
<thead>
<tr>
<th></th>
<th>Old Law (scratch/online)</th>
<th>July 2002</th>
<th>July 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Payouts</strong></td>
<td>50% (plus unclaimed prize money)</td>
<td>Scratch – Flexible Online – 50%</td>
<td>Scratch – Flexible Online – Flexible</td>
</tr>
<tr>
<td><strong>Transfers</strong></td>
<td>Scratch – 38% Online – 39%</td>
<td>Scratch – Flexible Online – 39%</td>
<td>Scratch – Flexible Online – Flexible</td>
</tr>
<tr>
<td><strong>Unclaimed Prizes</strong></td>
<td>100% to prizes</td>
<td>100% to prizes</td>
<td>20% to prizes 80% to education</td>
</tr>
</tbody>
</table>

The change in the law:

  • had an immediate impact on the various instant scratch-off price-points and payout percentages.
  • removed the Lottery’s dependency on unclaimed prize money as a way to increase payouts.
  • created an environment for sustained Lottery growth.
All games launched on or after July 1, 2002 featured the higher prize payouts. This chart shows the payouts – old and new – and the differences by price-point:

**Higher payouts for all games**

The Lottery’s transition strategy (from the old to the new) included multiple components:

- **The immediate infusion of higher payouts into all new games**
- **Phase out existing games with the old (lower) payouts over a six-month period**
- **A low-key approach to announcing the new, higher payouts:**
  - No media blitz. No fanfare.
- **Increased callouts (i.e., the total number of large cash prizes are shown on the ticket facing in a graphic banner)**
- **Increased “money-themed” games on the street from 15 in 2002 to 27 in 2006**
- **Increased launch of higher price-point games (in 2002, the Lottery sold five $5 games; by 2006, the Lottery was selling 14 games at $5 and higher)**
- **Increased product facings at retail (in June 2002 before the law was changed, Florida Lottery retailers, on average, carried 12.3 games; by 2006, that number had increased to 20.7 games).**
The Lottery's new prize structure strategy involved the following:

- An increase in the number of mid-tier prizes in the range of $25 to $600 from 18% of the total prize structure in 2002 to 29% in 2006
- An increase in the number of top prizes in the games
- No change to the overall odds of games
- Increased the percentage of prizes within a certain dollar range (by price point) within the prize structure:

<table>
<thead>
<tr>
<th>Price Point</th>
<th>Prizes</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1</td>
<td>$15 and $25</td>
</tr>
<tr>
<td>$2</td>
<td>$25 and $50</td>
</tr>
<tr>
<td>$5</td>
<td>$50 and $100</td>
</tr>
<tr>
<td>$10</td>
<td>$50 and $100</td>
</tr>
</tbody>
</table>

Although today's profit percentages are lower compared to pre-FY02 levels, Florida instant category net profits to the EETF increased 54% from FY02 to FY05 and continue to grow, and set new records to this day:
Georgia Lottery

The Georgia Lottery voluntarily reduced its instant ticket prize payouts in 1997 and immediately realized lower sales and gross profit. Between FY97 and FY98, gross profits from instant games declined 9.8%, from $266.4 million to $240.4 million.

Prize payouts were quickly enhanced and, beginning in 1998, instant game sales and gross profits in Georgia have continued to grow, as these charts illustrate:
Kentucky Lottery

With annual net profits (dividends to the state) from the instant scratch-off category declining from $41.67 million in FY90 to $24.9 million in FY91, the Kentucky Lottery increased its instant prize payouts to the 65% range beginning in FY92.

Within a year after the initiative was implemented, instant sales had increased $54.7 million (FY92 vs. FY91), with net profits from the scratch-off category increasing $9.74 million.

By FY93, instant sales had risen to $278.2 million, an increase of 131.9% compared to instant sales in FY91 ($120 million). Similarly, FY93 net profits from the scratch-off category were $29.75 million higher versus FY91 ($54.65 million vs. $24.9 million).

Between FY92 and FY00, the KLC’s instant category net profit percentage growth vs. FY91 ranged from 119.5% ($54.65 million) to 181.8% ($70.18 million), as this chart shows:

continued >> >
As the Lottery has added more higher-priced games to its instant category product mix, the prize payout percentage has continued to move higher. Average payouts, in fact, have been at, or above, 66.1% since FY02. As the chart below shows, this gradual, upward adjustment in the payout percentage has helped push instant sales and net profits to record levels.

A Fiscal Year 2005 recap on the Kentucky Lottery’s website summarized the effect the instant category is having on sales and net profits:

As the books close on Fiscal Year 2005, there’s good news to be found both for our sales and for our players. Faced with the loss of revenue from Tennessee residents, higher gas prices and increased competition for the entertainment dollar, we were projecting to sell $665.8 million in tickets this year [Note: Tennessee Lottery ticket sales began on January 20, 2004. Tennessee borders Kentucky to its South.]

However, thanks to a record-breaking sales level for our scratch-off tickets, we finished the year at $707.3 million. The biggest driving factor for these increased sales was scratch-off tickets. There were $385.1 million in scratch-offs sold last year, shattering the sales record set in FY04 by $28.1 million (+7.9%).

Since FY05, sales and net profits have continued to set new records:
Massachusetts Lottery

The Massachusetts Lottery was the first to capitalize on the dynamic incremental profit potential of higher instant prize payouts.

It is also the lottery that gave rise to the phrase, “Less of more is better than more of less.”

**Translation:** Returning a lower percentage of sales to the state and using these dollars for increased prize payouts will lead to more sales and higher net revenues. This approach adds more value to the ticket purchase (i.e., chance of winning exciting prizes improves) and is thus a better long-term strategy for building incremental revenue compared to one in which a higher percentage is returned to the state (i.e., less money for prizes, which reduces the chance of winning).

Over time, the latter strategy has been shown to detrimentally impact sales and produce gradually declining revenue for beneficiary programs. The reason: players do not win often enough or do not win prizes significant enough to keep them interested and thus they stop playing the games.

*continued >>*
The first evidence of the effectiveness of employing a higher payout strategy in Massachusetts can be traced to Fiscal 1984. That year, the Lottery began raising its instant prize payouts and has continued raising them with results that have aligned with its ultimate goal of increasing net profits for beneficiary programs.

Since FY05, annual instant ticket sales in Massachusetts have exceeded $3 billion from a population base of only 6.4 million people. And though its average payout percentage is the highest in the industry, its per capita net profits are significantly higher than all other US lotteries – resulting in major benefits for the state's 351 cities and towns, the primary recipients of Lottery funding.
Missouri Lottery

In recent years, the Missouri Lottery has moved aggressively to raise its instant prize payouts and, as a result, has watched sales and net profits reach new, record levels.

The Lottery undertook a most ambitious initiative at the end of FY01:

- *Raising aggregate instant prize payouts from 60.68% to 65.39% (July 2001)*;
- *Upgrading its Instant Ticket Vending Machine program (October 2001), increasing the number of bins from 8 to 15 and 16.*

Missouri is an example of how these types of initiatives can take time for players and retailers to see and appreciate the difference between the old, lower-payout games and the new, higher-payout games.

<table>
<thead>
<tr>
<th>FY</th>
<th>Distributed Sales (July thru June)</th>
<th>Estimated Profit</th>
<th>Estimated Transfer</th>
<th>Payout</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>$272.658 million</td>
<td>26.00%</td>
<td>$70.891 million</td>
<td>60.66%</td>
</tr>
<tr>
<td>2002</td>
<td>$316.397 million</td>
<td>22.30%</td>
<td>$70.557 million</td>
<td>65.39%</td>
</tr>
<tr>
<td>2003</td>
<td>$393.981 million</td>
<td>22.20%</td>
<td>$87.464 million</td>
<td>66.49%</td>
</tr>
<tr>
<td>2004</td>
<td>$434.791 million</td>
<td>22.64%</td>
<td>$98.436 million</td>
<td>66.70%</td>
</tr>
<tr>
<td>2005</td>
<td>$467.326 million</td>
<td>22.99%</td>
<td>$107.449 million</td>
<td>66.86%</td>
</tr>
<tr>
<td>% Growth*</td>
<td>71.40%</td>
<td></td>
<td>51.57%</td>
<td></td>
</tr>
</tbody>
</table>

* FY01-FY05

As you can see in the above chart, comparing FY02 to FY01, distributed instant sales rose $43.73 million while the estimated transfer to the state declined $334,541. FY02 was the first year of the prize structure change and represented, in the Lottery’s words, “a transition year” in which instant games featuring lower prize payouts were gradually being replaced by higher prize payout games.

It would take some time before these lower payout games would be depleted from retail stores. And so for a period of time after the prize payouts were increased, players were actually exposed to both lower payout games and higher payout games.

By FY03, all instant games on the street featured the higher prize payouts and it was then that the full impact of the prize payout increase was realized. In fact, FY03 distributed instant sales were $121.3 million higher compared to FY01. Similarly, the estimated transfer in FY03 was $16.5 million higher versus FY01.
Contributing to the Lottery's incremental sales and profit success story, in addition to higher payouts, were the:

- Implementation of a consignment program for retailers (July 2002)
- Introduction of the $10 price-point (August 2002)
- Introduction of multiple $5 games (October 2002)
- Introduction of multiple $10 games (November 2002)

It is important to note that the aggressive rollout of higher-priced games was a function of the Lottery having the flexibility to add more prize money to these games. The Lottery also took a low-key approach to announcing the new, higher payouts. There was no media blitz or fanfare.

The Missouri Lottery's overall instant prize payout has increased gradually since FY02 due to moving players to higher-priced games. Players' transition to higher-priced games is consistent with the Lottery's price-point positioning strategy. Note that the Lottery has not increased its prize-percentage-by-price-point since FY02 — with the exception of a 3% increase in its $10 category of instant games. This increase has been necessary to fund the Lottery's popular MegaGames. Missouri instant sales and net profits continue to show impressive growth:
The North Carolina Education Lottery (NCEL) started ticket sales on March 31, 2006, less than six months after the Oklahoma Lottery start-up on October 12, 2005. The similarities do not stop there. Both lotteries also operated under the most onerous prize payout restrictions in the nation.

Since inception, both lotteries have completed three full fiscal years of instant sales (FY07, FY08 and FY-09). From the start of FY07 through FY09, the NCEL had increased its instant sales by more than 61.57% and its transfer of profits to Education by 30.70%, as Table 1 below reveals.

<table>
<thead>
<tr>
<th>North Carolina Instant Category Sales</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Instant Sales</td>
<td>$494,314 million</td>
<td>$635,800 million</td>
<td>$798,676 million</td>
<td></td>
</tr>
<tr>
<td>Weekly Instant Sales</td>
<td>$9,506 million</td>
<td>$12,228 million</td>
<td>$15,359 million</td>
<td>+61.57%</td>
</tr>
<tr>
<td>Average Instant Prize Payout</td>
<td>54.38%</td>
<td>58.42%</td>
<td>64.00%</td>
<td></td>
</tr>
<tr>
<td>Gross Sales of Instant and Online</td>
<td>$885,575 million</td>
<td>$1,078,179 million</td>
<td>$1,293,111 million</td>
<td></td>
</tr>
<tr>
<td>Transfer of Profits to Education</td>
<td>$314,354 million</td>
<td>$347,327 million</td>
<td>$410,876 million</td>
<td>+30.70%</td>
</tr>
</tbody>
</table>

Table 1

The NCEL instant sales and gross profit increases can be traced to a legislative mandate reducing the state's original profit-percentage requirement. Payout relief was approved in September 2007. The initiative has given the NCEL the flexibility to begin launching higher-priced games with attractive prize structures (higher payouts) that are able to meet player expectations. It should be noted that it would take until mid-January 2008 before sufficient new inventory of higher-payout games began showing a positive effect on sales. This time lag is consistent with what other states have experienced when transitioning to a higher instant-payout strategy.

The NCEL opted not to increase its advertising support to call attention to the higher payout games, with the exception of its $10 game, which proved to be beneficial to sales. The NCEL sold the bulk of its first-ever $10 game in only seven months (16 million tickets accounting for approximately $160 million in gross revenue from this one game alone).

In the first part of FY09 (July 1, 2008 through Week Ending November 15, 2008), Instant games priced at $5 and $10 accounted for nearly half (48.28%) of NCEL category sales. Through this same period, $130 Million Blockbuster, the Lottery’s $10 game, accounted for more than 38% of total NCEL instant sales. They have since introduced 2 more $10 games experiencing similar success. In October 2009, the NCEL introduced its first $20 instant game which is outselling the $10 games.

The NCEL finished FY09 with a 20% increase in total sales and an 18.2% increase in return to education over the FY08. The return to education was $410 million up from $347 million the previous year.

In the U.S., the instant ticket category accounted for 57% of total lottery sales in Fiscal 2008 versus 43.8% in Fiscal 2002. Much of this growth is attributable to the player’s acceptance of higher-priced instant tickets – price-points lottery players are more adaptable than others in the industry, having flexibility to dedicate more money to prizes.

Restrictive payouts preclude lotteries from introducing higher-priced games because the prize structure is not able to meet high player expectations. Industry research consistently shows that players have a higher expectation of winning a prize when they purchase a higher-priced ticket. Restrictive payouts preclude lotteries from meeting these elevated player expectations. Historically, lotteries whose payouts are restricted tend not to introduce the kinds of higher-priced games that are driving today’s impressive instant category increases. North Carolina’s loosened payout restrictions have enabled its lottery to begin realizing the kind of growth most other U.S. lotteries have been experiencing for several years.
North Carolina Education Lottery

The North Carolina Education Lottery (NCEL) started ticket sales on March 30, 2006, less than six months after the Oklahoma Lottery start-up on October 12, 2005.

From their inceptions, both lotteries operated under the most onerous prize payout restrictions in the nation. But that would change in September 2007 when the North Carolina state legislature chose to grant the NCEL payout relief on its lottery games. This legislative action has since propelled the NCEL's instant sales and gross profits to new heights. In contrast, the Oklahoma Lottery's business model, with respect to payouts, has remained unchanged and instant ticket sales have paid the price, declining by a double-digit percentage between the start of FY07 (July 1, 2006) and the first 18 weeks of FY09.

<table>
<thead>
<tr>
<th></th>
<th>FY07 Wkly Instant Sales</th>
<th>FY08 Wkly Instant Sales</th>
<th>FY09* Wkly Instant Sales</th>
<th>FY07-09 % change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oklahoma</td>
<td>$1,886,538</td>
<td>$1,678,846</td>
<td>$1,613,235*</td>
<td>-14.49%</td>
</tr>
<tr>
<td>North Carolina</td>
<td>$9,506,049</td>
<td>$12,228,463</td>
<td>$14,088,622*</td>
<td>+48.21%</td>
</tr>
</tbody>
</table>

* July-October 2008

During this approximately 28-month period, NCEL instant sales increased 48.21% while Oklahoma Lottery instant sales declined 14.49%.

The tables at the top of the next page reveal, in more detail, the NCEL's sales and gross profit story for its instant category. The table on the left shows Total Instant Sales/Growth Profit; the table to the right shows Weekly Instant Sales/Gross Profit.

NOTE: The NCEL defines gross profit as total instant sales less prizes and before adjustments for operating expenses.
The NCEL’s gross instant profit increased by approximately 38.40% between FY07 and the first 18 weeks of FY09. The state legislature granted the NCEL prize payout relief in September 2007, giving the Lottery much-needed flexibility to begin launching higher-priced games featuring higher payouts. Much of the instant category growth in the U.S. today can be attributed to a lottery’s higher-priced games. North Carolina’s relaxed payout restrictions have enabled the NCEL to begin offering these games and experiencing the kind of growth other U.S. lotteries have experienced for several years.

The NCEL instant sales and gross profit increases can be traced primarily to a legislative change relaxing the requirement to return 35% to education in order to maximize the available revenues for education purposes. Payout relief was approved in September 2007. The initiative has given the NCEL the flexibility to begin launching higher-priced games with attractive prize structures (higher payouts) that are able to meet player expectations. It should be noted that it would take until mid-January 2008 before sufficient new inventory of higher-payout games would begin showing a positive effect on sales. This time lag is consistent with what other states have experienced when transitioning to a higher instant-payout strategy.
When the first higher prize payout instant games were introduced to the marketplace in October of 2007, the NCEL produced in-store point-of-sale (POS), a television commercial, and a radio spot to get the word out. These were generic messages, "Instant games from the North Carolina Education Lottery, now with higher payouts." The NCEL introduced its first $10 higher prize payout game in mid January of 2008. It was supported with in-store POS, television and radio and featured game-specific messaging. The NCEL sold the bulk of this "higher-prize-payout $10 game" in only seven months (16 million tickets accounting for approximately $160 million in gross revenue from this one game alone).

In FY09 (July 1, 2008 through Week Ending November 15, 2008), Instant games priced at $5 and $10 accounted for nearly half (48.28%) of NCEL category sales. Through this same period, $130 Million Blockbuster, the Lottery’s $10 game, accounted for more than 38% of total NCEL instant sales.

In the U.S., the instant ticket category accounted for 57% of total lottery sales in Fiscal 2008 versus 43.8% in Fiscal 2002. Much of this growth is attributable to the player’s acceptance of higher-priced instant tickets – price-points lotteries have made attractive by having the flexibility to dedicate more money to prizes.

Restrictive payouts preclude lotteries from introducing higher-priced games because the prize structure is not able to meet player expectations. Industry research consistently shows that players have a higher expectation of winning a prize when they purchase a higher-priced ticket. Restrictive payouts preclude lotteries from meeting these elevated player expectations. Historically, lotteries whose payouts are restricted tend not to introduce the kinds of higher-priced games that are driving today’s impressive instant category increases. North Carolina’s loosened payout restrictions have enabled its lottery to begin realizing the kind of growth most other U.S. lotteries have been experiencing for several years.
New York Lottery

The New York Lottery offers another example of higher instant prize payouts driving sales and net profits significantly higher.

For years, the Lottery's average instant prize payout was restricted to 55%. With instant sales declining and total lottery aid to education correspondingly on the decline, the legislature took action, granting the Lottery authorization to lift the prize payout restriction in an effort to increase sales and net proceeds.

In October 1999, the New York Lottery began phasing in new instant games with higher prize payouts. The payout initiative took New York's average instant prize percentage from 55.01% to 68.09%. And though a positive impact was not immediately felt (a transition period was necessary to deplete the old, lower-payout games), Lottery-supported educational programs in New York today are benefiting greatly from the higher payout initiative, as this chart clearly shows:

![Chart showing sales and prize payout over years]

- **Instant Sales**
- **Revenue From Instant Category** (Assumes 15% for administrative costs)
- **Instant Prize Payout**

Revenue figures, above, are unaudited and do not include any additional administrative surplus.
Texas Lottery

Rarely does a jurisdiction lower its prize payouts, yet that is exactly what the state of Texas did in the late 1990s. What followed was a painful lesson, one that was not at all envisioned when the state legislature embarked on what turned out to be a short-lived initiative.

The Texas Lottery began sales in May 1992 and, like most start-up lotteries, started with the instant game. In FY92, instant prize payouts were set at 45.5%. From FY93 to FY95, the percentage increased from 54.9% to 60.2%. In its first five full fiscal years, Texas's instant sales flourished, rising to $2.357 billion in FY97. In fact, Texas placed second in the U.S. in per capita instant sales behind only Massachusetts, the world's perennial instant ticket leader.

Then, in 1997, a legislative mandate ordered the Texas Lottery to do the following: "Reduce its overall prize payouts by 4.5% in FY98 and by an additional 5% in FY99."

A year after fully implementing this two-phased mandate, Texas Lottery sales (all games) had declined 31%, with instant ticket sales dropping 40%. So dramatic and precipitous was the decline that the legislature quickly reversed its position (during the legislative session ending in May 1999), passing a bill that provided for the return of prize payouts for Lottery games to previous levels.

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*The Texas Lottery Commission does NOT track separate operating costs or earning contributions by products. The above are merely estimates.
With payouts reinstated to previous levels in the summer of 1999, once again Texas began introducing instant games with higher prize payouts. Instant ticket sales gradually improved, but it would take eight years before sales and profits would surpass the levels established in 1997. Today, the Lottery's current average instant prize payout exceeds 67%.

* The Texas Lottery Commission does NOT track separate operating costs or earning contributions by products. The above are merely estimates.

** Only total return to the state available.
Total return to the state for these fiscal years was as follows:
FY06: $1.028 Billion
FY07: $1.023 Billion
FY08: $984 Million