

Oregon State Lottery



WRITTEN TESTIMONY

Date: April 15, 2013

To: The Honorable Carolyn Tomei, Chair
The Honorable David Gomberg, Vice Chair
The Honorable Andy Olson, Vice Chair
House Committee on Human Services and Housing

From: Larry Niswender, Director
Oregon State Lottery

Re: **HB 3377 with -1 Amendments** – Amends ORS 461.220 and limits the amount the Lottery Commission may spend to advertise the state lottery in a biennium and requires that a fixed amount be spent on advertising directed to prevent and treat addiction and other emotional and behavioral problems related to playing lottery games.

Good afternoon. For the record, my name is Larry Niswender. I am the Director for the Oregon Lottery®. The Oregon Lottery® is not taking a position on this bill, as of today. We are here to provide factual and historically relevant information to inform the Committee, to highlight relevant current law provisions, to share policy considerations, and address any questions you may have for the Lottery.

While the Lottery is not taking a position on the bill, the bill still raises policy, legal, fiscal, and funding source concerns. **Note:** Lottery expresses no opinion on the constitutionality of this bill or any of its provisions.

Proposed Amendments:

The -1 amendments to HB 3377 would place a ½ of one percent or less cap on the amount of the Lottery's net proceeds (revenue less prizes) that could be spent in a biennium on advertising and require that a \$4 million fixed biennial amount from within the cap amount be spent on advertising directed to prevent and treat addiction and other emotional and behavioral problems related to playing Lottery games.

HB 3377 with -1 Amendments - Require Significant Advertising Spending Reduction

In FY 13, Lottery's annual net proceeds (revenue less prizes) are projected to be approximately \$853 million and ½ of one percent of this amount is \$4.3 million per year. In FY 13, Lottery's budget for advertising was \$8.5 million.

Based on the -1 amendments, Lottery would have had to reduce its annual advertising budget of \$8.5 million and limited it to \$4.3 million or less per year (cut in half) and then spend \$2 million of this reduced annual amount for advertising to prevent and treat addiction and other emotional and behavioral problems related to playing lottery games.

HB 3377 with -1 Amendments - Require Alternative Funding Source

Spending \$2 million annually as described would be contrary to recently received DOJ legal advice. This advice confirms that expenditures on advertising communications directed to prevent and treat addiction and other emotional and behavioral problems related to playing Lottery games would have to come from an alternative fund source.

The advice confirms that Lottery expenditures need to be limited to those necessary or required to internally implement and manage the Lottery, which could include advertising for responsible gambling.

New Activities Required by the Bill – Ways and Means Review Needed

Since the bill requires new activities that would require an alternative fund source (such as the General Fund), it would have a fiscal impact. As such, it continues to be appropriate for this bill to have a subsequent referral to Ways and Means. This referral will allow time and opportunity to identify and appropriate necessary funds.

Because the -1 amendments will place a significant limit on Lottery's annual advertising expenditures, we wanted to take a few minutes to inform the Committee on the impact of advertising on sales.

Historic Context and Discussion:

Lottery's Mission

The Oregon Lottery® operates under a constitutional framework which defines its mission:

“To operate a lottery with highest standards of integrity and security to earn maximum profits for the people of Oregon commensurate with the public good”.

The Oregon Lottery®, under the direction of its five member Commission, interprets this mission by breaking it into three areas of responsibility:

- **Return Maximized Profits:** Through cost management, intelligent investments in marketing and systems and maximizing the efficiency of its labor pool, both internal and contracted, the Lottery returns maximum profits to support important projects and programs.
- **Stable Sales Performance:** Through offering a diverse line of products that match the changing preferences of a broad and diverse audience of Oregon consumers, the Lottery is able to contribute a steady return of profits making the Oregon Lottery® a reliable source of revenue into the future.
- **Commensurate with Public Good/Balance:** The Lottery maintains balance through responsible gambling programs and through effective risk management.

Key Operational Challenges

The current key challenges to continue to meet transfer objectives and remain a stable funding source for Oregon include:

- **Economy/Competition:** The economic downturn resulted in more competition for discretionary spending; and the smoking ban, which resulted in declines in Video LotterySM and Keno sales and prompted some players to move their play to tribal casinos, where smoking is still allowed;
- **Player Base Changes:** While favorability ratings of the Lottery are at an all time high, the post-baby boomer generation consumes media and entertainment products differently. It is more difficult to reach this audience. Baby boomers who represent the Lottery's core player base are aging/retiring/passing on;

- **Education Need:** In order to sustain revenue transfers, the Lottery needs to continue to reach out to a diverse set of consumers to educate them about the Lottery's product offerings. Current Status of Legal Advice – Spending for Responsible Gambling & Problem Gambling Activities

Impact of Advertising on Sales

Advertising allows the Lottery to do many critical things. These include the ability to:

- Introduce new games and game features;
- Achieve business and revenue transfer goals;
- Remain competitive;
- Maintain favorability;
- Support retailers;
- Communicate with players; and
- Build a diverse player base.

Annually conducted research continues to show that there are wide audiences of Oregonians who do not know that the Lottery offers spinning reel (line) games. Many of them frequent the type of locations where Lottery products are offered but have not tried the games.

Research has confirmed that there is an opportunity to reach a broader player base (potential players), if consumers understand what types of Lottery games offered.

Below are excerpts from a number of industry studies, including an analysis of Oregon Lottery[®] and market data which was conducted by Alan Resnik, Professor of Marketing at Portland State University in 2006:

- Oregon Lottery[®] advertising is effective:
 - Spending to date is driving current sales levels;
 - Campaign specific promotions increase sales; and
 - TV advertising drives brand awareness and opinion.
- Eliminating advertising creates market risks, such as:
 - Reduced participation of current Lottery players; and
 - Inability to educate and attract new players.
- Advertising is critical to long-term success:
 - Advertising impact depreciates within six months;
 - New product development requires launch advertising;
 - Continued messaging is required to attract new buyers;
 - Results from other state lotteries show negative impact from advertising cuts; and
 - The Study concludes that every 1 cent decrease in advertising resulted in a 31 to 38 cent decline in sales*.

- Oregon Lottery® Comparative Category Spending is Low**
 - As compared to other US lotteries, the Oregon Lottery’s advertising budget as a percent of total sales is on the low end of the range. Based on 2011 data, advertising spend as a percent of total sales across lotteries ranges from .4% to 4.2 percent.
 - The Oregon Lottery’s advertising budget as a percent of sales is also on the low end as compared to the range of advertising spend as a percent of sales observed across other industries. When looking at industries including Entertainment, Retail, Consumer and Packaged Goods, advertising as a percent of sales can range from 2% to 6 percent.

* Source: Economic Analysis of the State Lotteries in the United States, University of Maryland, 2004, p 107-120

** Source: La Fleur’s World Lottery Almanac

*** Source: Marketing Management Analytics industry benchmarks database

Other Considerations

The number of retailers offering Video LotterySM has reversed from a history of steady growth to a decline. For example, in calendar year 2010, the Lottery had 2,370 video retailers, but in 2011 it dropped by 17 (to 2,353) and in 2012, it dropped again by another 37 (to 2,316). As such, in the last two years the total has dropped by 54 retailers.

Small Oregon retailers are struggling to survive in today’s economy. A number of retailers in the food and beverage industry, who were challenged not only by the downturn in the economy but by the smoking ban, have shut their doors. Lottery advertising helps drive business to these retailers, many of whom cannot afford to advertise on their own.

Oregonians can still engage in the play of line and poker games while smoking at Oregon tribal casinos, which have a far broader game selection than Oregon Lottery® retailers.

The tribal casinos also extensively advertise using all forms of media, including television, in order to compete for Oregonians’ discretionary income.

The Oregon Lottery® has very strategically and in a limited manner used the tools it has at its discretion to help stabilize the income from Lottery games which is the second largest state revenue source for the state’s budget.

Current Status of Lottery Advertising Expenditures

The Lottery Commission currently approves an annual budget for the Lottery operations, versus a biennial budget. The manner in which the Lottery Commission has allocated funds for advertising activities has been at or below 1 percent of the total forecast revenue (prior to prize payments) or approximately \$10 million or less per year.

The budgeted expenditures for the public information budget (Responsible Gambling and Oregon Wins Program) have been at 0.5 percent or less of total forecast revenue per year.

The FY 11 and FY 12 advertising budgets included \$8.7 million and \$4.6 million for public information. In total, \$13.3 million was annually budgeted, which equates to \$26.6 million in that biennial period. The FY 11 and FY 12 actual biennial expenditures were limited to \$22.3 million. Of this amount, approximately \$2.9 million was spent in the biennium on responsible gambling-related communications/activities.

Lottery's Key Concerns if Advertising Expenditures Would be Reduced

In order to sustain State transfer amounts, the Lottery needs to continue to have the ability to reach out to a diverse set of consumers to educate them about the Lottery's product offerings. Bills that would limit the Lottery's ability to advertise:

- Could impose an unconstitutional burden on the Lottery Commission's duty to establish and operate a State lottery and could also threaten the stability of the Lottery revenue stream.
- Could lessen the ability of the Lottery Commission to introduce new games, respond to unpredictable changes in the economy, maintain a diverse player base, and address ongoing and new competition for entertainment dollars.

Closing

This concludes our testimony. We would be happy to address any questions you may have for us. Thank you for your time and consideration of this testimony.