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Lottery Private Management Failing To Meet Elevated Expectations

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Privately-managed state lotteries have failed to meet ambitious income projections in Illinois, Indiana and New Jersey, but current and former lottery officials say it is too soon to condemn the private management model.

Although the three U.S. state lotteries to have come under private management have all seen increased sales, not one of them has met the annual income projections established by their management contracts.

“This is a new business model in the United States that requires some adjustments and fine tuning,” Angela Wiczek, vice president of corporate communications for lottery giant Gtech, told GamblingCompliance.

Earlier this month, the State Lottery Commission of Indiana agreed to amend the revenue targets in its 2012 management services contract with Gtech Indiana.

Under the revised agreement, the company will now owe the state shortfall payments if it fails to deliver net lottery income of at least $270m during the 2016 fiscal year. Gtech would receive additional incentive payments only if income exceeds $290m, and it has also agreed to pay the state of Indiana a one-off sum of $18.25m as part of the restructuring.

The revisions come as the state now expects to receive just $243.4m in lottery income for the current fiscal year, which ends June 30, versus an initial target of $320m.

The lottery commission said the amendment “takes into account changes to the lottery market that could not reasonably have been anticipated prior to execution of the [management contract] in 2012.”

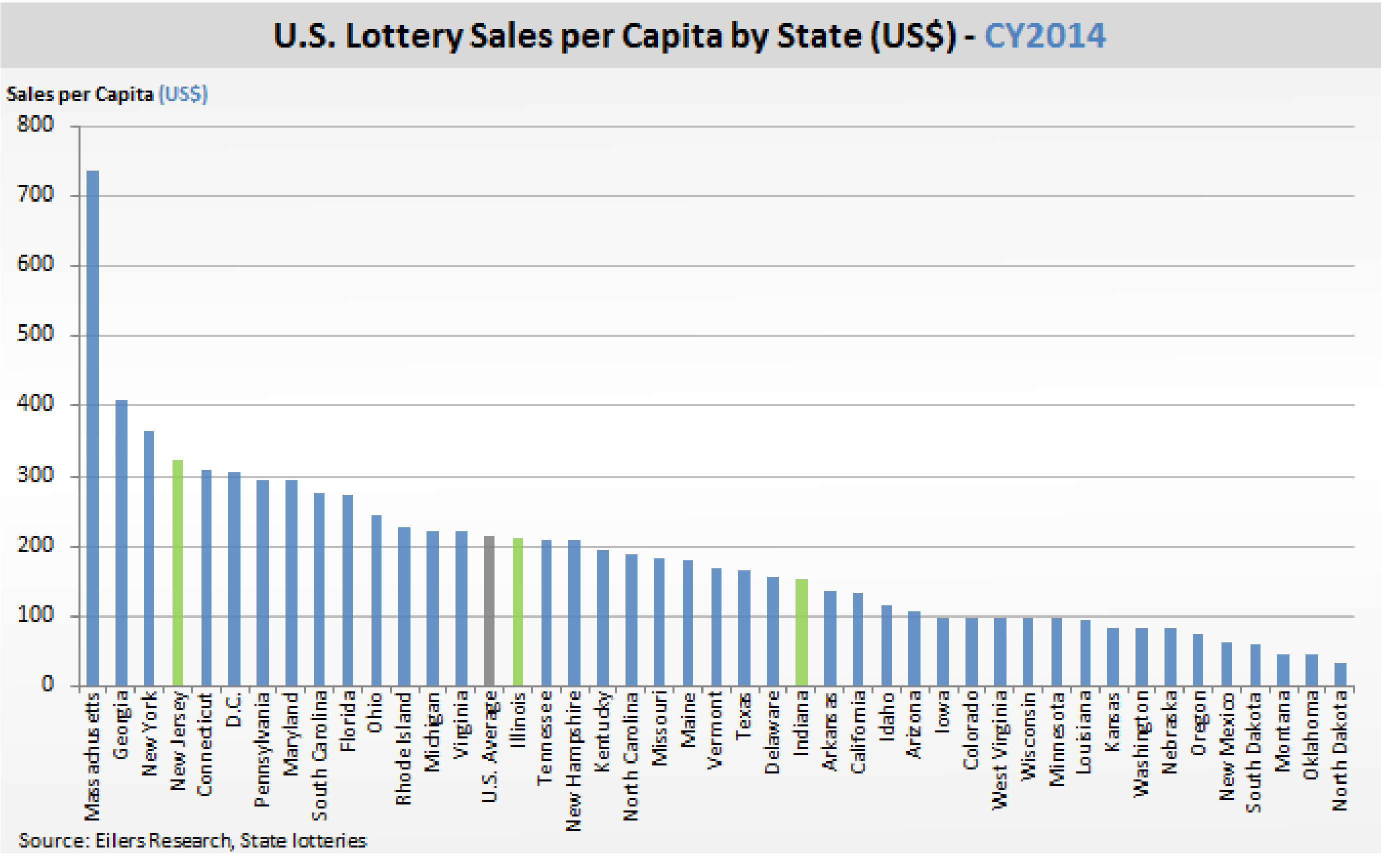
“We are committed to a long-term relationship with Gtech but understood the contract needed to be right-sized to better reflect the market,” a spokeswoman for the Hoosier Lottery told GamblingCompliance.

The adjustments in Indiana follow Illinois' move last year to abandon America's first lottery private management agreement when it fired Gtech-Scientific Games consortium Northstar over its failure to hit income targets for each of the first three years of a ten-year contract.

A legal agreement to dissolve the Northstar contract was shelved earlier this year, plunging the Illinois Lottery into a state of uncertainty.

"We are currently in ongoing, private discussions with Northstar at this time regarding the resolution of the agreement and will share more information as it becomes available," said Stephen Rossi, the communications director of the Illinois Lottery.

Meanwhile, lottery private management also appears to be falling far short of initial expectations in New Jersey.



Last month, budget officials revised New Jersey's estimated state lottery income for the 2015 fiscal year down to $930m versus an original target in Northstar's management contract of $1.047bn.

For fiscal 2014, Northstar delivered pro rata income of $705m versus a revised target of $767m.

Still, New Jersey officials insist the lottery's performance would have been worse without the private manager at the helm.

"Although net revenue to the state has not met expectations, we believe that Northstar's investment and activities to date have shielded New Jersey from the worst of what is clearly a national scale, industry-wide decline in lottery sales and net revenues," said Carole Hedinger, the executive director of the New Jersey Lottery, in a statement.

Industry observers cite a number of factors that have constrained recent growth in U.S. lottery sales, including so-called jackpot fatigue affecting the Mega-Millions and Powerball multistate games, as well as the inability of state lotteries to attract major "big box" chains as retailers.

However, some also believe that operating constraints and state politics remain significant obstacles to the success of private management.

Although states may partially privatize their operations, a 2008 U.S. Department of Justice legal opinion still requires them to retain "actual control" over all business decisions made by their lotteries.

"The lottery revenue projections were based on an erroneous assumption that you can expand the types of games and avenues where the games are provided," said Robert McLaughlin, a former director of the New York Lottery and now head of the law firm Hodgson Russ' gaming practice in Albany.

"But you also have state governments which may not be entirely on board and you can't meet your revenue projections because the managers are not allowed to do what they proposed in the first place."

"Part of the problem with private management is that managers need some major accommodations to reach the numbers projected in their bids," said Stephen Martino, partner with law firm Duane Morris in Baltimore and a former director of the Maryland and Kansas state lotteries.

Advocates of private management have cited the need for state lotteries to gain greater flexibility in the procurement of new technologies and incentivizing sales performance.

Unlike other state government agencies, lotteries are a consumer-facing business, said Kurt Freedlund, president of Lotto Interactive Inc. and a former chief operating officer of the Georgia Lottery Corporation.

"With the lottery you are selling a product in the marketplace and you are a sales and marketing organization," Freedlund told GamblingCompliance.

"A couple of the new lotteries like Georgia are set up as public corporations where they have the ability to hire the right personnel to operate the lottery with business backgrounds," he said.

"They are able to generate more revenue for the state than having to pay a fee for the private manager to do it."

Still, current and former lottery officials believe it is the elevated revenue projections set by private management contracts that have clouded the measurement of their success and left them open to political attack.

“People expected a little too much from Illinois and Indiana when they switched over and they fell somewhat short of the goals that have been set, but by and large they have been relatively successful,” Minnesota Lottery executive director Ed Van Petten said.

“For various reasons, the revenue projections may have been too high in the first place,” echoed Freedlund. “And consequently, the contracts are deemed a failure.”

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