## FY 2010 BUDGET REDUCTIONS - SUMMARY OF ISSUES
## ARIZONA LOTTERY

### ALL NON-GENERAL FUNDS

**FY 2010 All Non-General Funds Budget (less Federal Funds)** **74,374,200**

**AGENCY REDUCTION TARGET - ALL NON-GENERAL FUNDS (w/o Federal Funds)** $11,156,000

| Fund | Reductions Amount | Percent Reductions |
|---|---|---|
| Lottery Fund | $11,156,000 | 100.0% |
| **Issue Total** | **$11,156,000** | |

All Non-General Funds Total as a Percentage of Agency Non-GF Reduction Target 100%

# FY 2010 BUDGET REDUCTIONS - SUMMARY OF ISSUES
# ARIZONA LOTTERY

## LOTTERY FUND

**FY 2010 All Non-General Funds Budget (less Federal Funds)** **74,374,200**

**AGENCY REDUCTION TARGET - ALL NON-GENERAL FUNDS (w/o Federal Funds)** $11,156,000

| Priority | Issue Title[1] | Reductions Amount |
|---|---|---|
| 1 | Close Tucson office | $250,000 |
| 2 | Additional salary reduction | $300,000 |
| 3 | Further advertising reduction | $4,500,000 |
| 4 | Adjust retailer commission rate from 6.5% to 6.0% | $2,400,000 |
| 5 | Eliminate ticket vending machines | $1,600,000 |
| 6 | Reduce instant ticket games | $2,106,000 |
| | **Issue Total** | **$11,156,000** |

Fund Total as a Percentage of Non-General Fund Reduction Target 100%

[1] Please complete the attached Description and Impact Statement for each issue.

**STATE OF ARIZONA**
**FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

**Arizona Lottery**

**Issue Title:** Close Tucson Office

**Issue Priority: 1**

**Reduction Amounts:**
Lottery Fund: $250,000

**Amount: $250,000**

**<u>Issue Description and Statement of Effects</u>**

**Description:** The Lottery has a Tucson office that serves as the southern Arizona location for winner redemptions, ticket sales, and customer service. This office is also the base for sales staff providing services to southern Arizona retailers.

**Potential Savings:** $250,000.
This amount reflects: $65,000 in lease payments, $185,000 in Personal Services/ERE/
misc operating).

**Impact on Revenue:** $900,000.
The Tucson office generated approximately $900,000 in revenue for FY09. Although most of this revenue would likely be redirected to other retail locations, the Lottery estimates that 25% would be lost entirely, or about $225,000 per year.

**Operational Impact:** Closing the Tucson office would result in four employees that would lose their positions. The Tucson office also serves as the Lottery's backup computer site for business continuity; the Lottery would have to determine another location for this purpose and move existing equipment. Closing the office would also create an inconvenience for southern Arizona Lottery players since winners in excess of $599 wishing to claim their prize in person would now be required to travel to Phoenix. The Lottery would likely receive negative press and an influx of angry comments from players.

**Impact on Distributions:** $74,200.

This assumes a potential sales loss of $225,000, an overall distribution transfer rate of 26.5%, plus 6.5% commission on those sales, which the Lottery returns as operational savings.

**Statutory Citation:** Tucson office expenses are included in the percentage of revenues allocated for operations, as outlined in A.R.S. § 5-505.

**STATE OF ARIZONA**
**FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

**Arizona Lottery**

**Issue Title:** Additional Salary Reduction

**Issue Priority: 2**

**Reduction Amounts:**
Lottery Fund: $300,000

**Amount: $300,000**

**<u>Issue Description and Statement of Effects</u>**

**Description:** A salary reduction of $200,300 is already required for FY10. An additional $300,000 reduction would be necessary to meet a 15% overall reduction goal.

**Potential Savings:** $300,000.

**Impact on Revenue:** Unknown impact.
Little anticipated impact on existing revenue; future revenue potential could be affected, although the exact amount cannot be determined.

**Operational Impact:** The agency conducts statewide operations with a limited number of personnel – typically about 100 employees - so any reduction in personnel greatly impacts the workload of remaining employees. The Lottery is currently operating with only 93 positions as a result of personnel actions taken to meet recent budget reductions. This means that certain key positions must remain vacant to meet these funding obligations. Personnel reductions can compromise the Lottery's ability to generate revenue. New game initiatives require sufficient resources to implement; some initiatives may have to be postponed or abandoned altogether due to lack of personnel.

**Impact on Distributions:** Unknown impact.
The timely ability to introduce new games or redesign existing games directly impacts revenue, which ultimately affects funding for beneficiaries.

**Statutory Citation:** Personnel expenses are included in the percentage of revenues allocated for operations, as outlined in A.R.S. § 5-505.

**STATE OF ARIZONA**
**FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

**Arizona Lottery**

**Issue Title:** Further Advertising Reduction

**Issue Priority: 3**

**Reduction Amounts:**
Lottery Fund: $4,500,000

**Amount: $4,500,000**

**Issue Description and Statement of Effects**

**Description:** The Lottery was authorized to spend approximately $20 million for advertising purposes in FY09, a significant increase over the previous advertising cap of $11 million. This was part of a strategy passed in the 2008 Legislative Session to increase Lottery sales and resulting transfers. The advertising appropriation was subsequently reduced to $16 million for FY10, with the difference of $4,162,700 to be transferred to the General Fund. An additional forced advertising cutback would be necessary to achieve the 15% decrease; remaining advertising funds would be approximately the same as the previously appropriated level of $11 million, effectively reversing funding progress made to-date.

**Potential Savings:** $4.5 million.

**Impact on Revenue:** $36 million.
This amount assumes an advertising return of 8:1, which is fairly conservative by industry standards. Sales would be expected to decline by the corresponding amount.

The Lottery has begun to see the impact of additional advertising on sales. As an example, the Lottery strategically supported holiday Scratchers sales last fiscal year, and despite a tough economy, holiday ticket sales increased almost 63% over the previous year. A similar strategic approach boosted sales of the Millionaire Raffle. Targeted advertising was run during the final days of the raffle, starting first in the smaller Tucson market to gauge the impact, and then in Phoenix. Final sales of the game exceeded the previous raffle by almost $1.5 million. Preliminary reports indicate other western lottery states have experienced declining or stagnant sales. This industry-specific knowledge has helped to validate the importance of additional advertising funds.

**Operational Impact:** Lottery staff will need to reassess initiatives and priorities to best maximize remaining advertising funds. The Lottery will need to halt some advertising initiatives already planned for the second half of FY10.

**Impact on Distributions:** $9.5 million.
This assumes a potential sales decline of $36 million and an overall distribution transfer rate of 26.5%.

**Statutory Citation:** Advertising expenses are included in the percentage of revenues allocated for operations, as outlined in A.R.S. § 5-505.

**STATE OF ARIZONA**
**FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

**Arizona Lottery**

**Issue Title:** Adjust Retailer Commissions from 6.5% to 6.0%

**Issue Priority: 4**

**Reduction Amounts:**
Lottery Fund: $2,400,000

**Amount: $2,400,000**

**<u>Issue Description and Statement of Effects</u>**

**Description:** Lottery retailers currently earn a base rate of 6.5% for each transaction, plus up to an additional .5% based on meeting performance criteria. Laws 2008, Chapter 287, Section 2 revised the compensation rate to a range of 5.5%-8%. This statutory change would provide the authority to revise the base commission rate to 6.0% and maintain the current one-half percent for performance incentives.

**Potential Savings:** $2.4 million.
This figure is based on the JLBC sale forecast of $482.2 million for FY10.

**Impact on Revenue:** Unknown impact.
The exact impact of this option would be difficult to predict. Some degree of lost sales could occur as the retailer's incentive to sell Lottery products would decline. Space in retail locations is highly competitive, especially given current economic conditions. Retailers could choose to replace Lottery products with a more profitable item if commissions decrease on Lottery sales. There is also the possibility some retailers would choose to no longer sell Lottery products. The impact would be substantial if an entire chain (i.e Circle K) made this decision. Lottery sales for this retail chain were $118.9 million last fiscal year. Both revenue and retailer relationships would be negatively affected as a result of this option. The exact impact is unknown, but is expected to be substantial.

**Operational Impact:** Lottery retailers would definitely be displeased with this option. Retailer relationships would be compromised, affecting working relationships into future years. There is also likely to be vocal opposition from the business community, especially in jurisdictions where Lottery commissions

may be helping small businesses stay open, and where those dollars are reinvested in the community in the form of salaries, inventory or taxes.
The Lottery would incur programming costs that would have to be absorbed within the existing appropriation.
*Note: the Lottery has a final rulemaking package at the Governor's Regulatory Review Council to make the commission rates in rule consistent with statute. This rule amendment is on hold due to the moratorium, but would need to be effective before this option could be implemented.*

**Impact on Distributions:** Likely to impact, but not quantifiable.

**Statutory Citation:** Retailer commission expenses are included in the percentage of revenues allocated for operations, as outlined in A.R.S. § 5-505.

**STATE OF ARIZONA**
**FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

**Arizona Lottery**

**Issue Title:** Eliminate Ticket Vending Machines

**Issue Priority: 5**

**Reduction Amounts:**
Lottery Fund: $1,600,000

**Amount: $1,600,000**

**Issue Description and Statement of Effects**

**Description:** The Lottery currently has approximately 600 ticket vending machines, which are essentially self-service machines for players to purchase Lottery tickets. The cost for this equipment is based on a percentage of revenue generated through the machine. Ticket vending machines accounted for slightly over 30% of instant ticket sales in FY09.

**Potential Savings:** $1.6 million.
Figure based on current annual sales levels.

**Impact on Revenue:** $53 million.
Total machine revenues are estimated at $80 million. The Lottery conservatively estimates a decrease in instant ticket sales of $53 million associated with this option. Although some on-line (Powerball, Pick, etc.) ticket sales would likely transfer to other points of purchase within the retail location (i.e. customer service counters), eliminating the machines will ultimately result in lost sales for the instant ticket product. Approximately 70% of the vending machines are located in large retail grocery stores. The majority of these stores do not have a secondary location from which to purchase instant tickets, so eliminating the vending machines would eliminate all instant sales for those stores.

**Operational Impact:** Little operational impact for the Lottery, other than having to cancel the current vending machine contract. Eliminating the machines would have a greater impact on retailers and players. The vending machines free up staffing requirements for retailers, take up minimal space within the store location, and provide players with a convenient way to purchase Lottery products. The Lottery would also lose the benefit of no-cost advertising associated with the signage capabilities of these machines.

**Impact on Distributions:** $12.1 million.
This assumes a potential sales decline of $53 million.

**Statutory Citation:** Ticket vending machine expenses are included in the percentage of revenues allocated for operations, as outlined in A.R.S. § 5-505.

**STATE OF ARIZONA**
**FY 2010 BUDGET REDUCTIONS - ISSUE DESCRIPTIONS**

**Arizona Lottery**

**Issue Title:** Reduce Instant Ticket Games

**Issue Priority: 6**

**Reduction Amounts:**
Lottery Fund: $2,106,000

**Amount: $2,106,000**

**Issue Description and Statement of Effects**

**Description:** Over the past five years, instant ticket sales have grown by almost 30% and currently represent approximately 57% of total sales. This option would require the Lottery to reduce the number of games printed per year by almost half. The Lottery currently prints approximately 52 games per year; 24 games would have to be eliminated with this option.

**Potential Savings:** $2.1 million.

**Impact on Revenue:** $74 million.
Some savings (about $100,000) might be accomplished by adjusting print quantities to print a larger quantity of tickets and using fewer custom printing options. However, increasing the number of tickets in a game does not automatically mean more tickets being sold; the longer a game remains in market, the less attractive it becomes to players. Custom options (specialty paper, inks) imply perceived extra value on higher-priced tickets; players may find them less appealing if these features are removed. Even with implementing these strategies, about 95% of savings would come at the expense of printing games, resulting in a loss of sales. With an average cost of $84,000 per game, this option would mean reducing game introductions by approximately 24 games per year (almost 50%). Assuming average sales per game of $3.1 million, the potential loss of revenue would be $74 million.

**Operational Impact:** Unlikely to impact.

**Impact on Distributions:** $16.9 million.
This assumes a potential sales decline of $74 million.

**Statutory Citation:** Instant ticket expenses are included in the percentage of revenues allocated for operations, as outlined in A.R.S. § 5-505.