1997-98 SESSION COMMITTEE HEARING RECORDS

Committee Name:

Joint Committee on Finance (JC-Fi)

Sample:

- Record of Comm. Proceedings
- 97hrAC-EdR_RCP_pt01a
- 97hrAC-EdR_RCP_pt01b
- 97hrAC-EdR_RCP_pt02

- Appointments ... Appt
-
- Clearinghouse Rules ... CRule
-
- Committee Hearings ... CH
-
- Committee Reports ... CR
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- Executive Sessions ... ES
-
- Hearing Records ... HR
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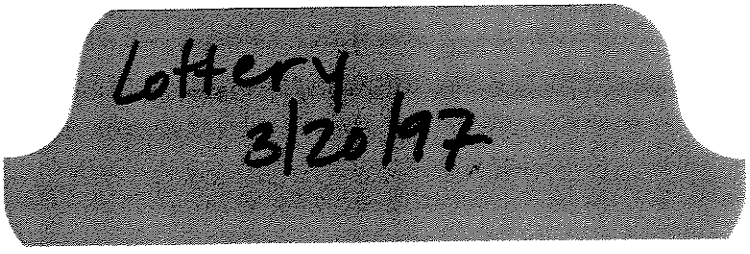
- Miscellaneous ... Misc
- 97hr_JC-Fi_Misc_pt04l_DPR
- Record of Comm. Proceedings ... RCP
-

Joint Finance

16.515/16.505
14 Day Passive
Reviews

3/13/17 -
5/7/17


Lottery
3/20/97

THE STATE OF WISCONSIN

SENATE CHAIR
BRIAN BURKE

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JOINT COMMITTEE ON FINANCE

March 21, 1997

Secretary Cate Zeuske
Department of Revenue
125 South Webster Street
Madison, Wisconsin 53708

Dear Secretary Zeuske:

We are writing to inform you that the members of the Joint Committee on Finance have reviewed the Department of Revenue Report on Lottery Sales submitted on February 28, 1997, pursuant to s. 565.02(7), Stats.

No objections or concerns have been raised about the report. Therefore, the report is approved.

Sincerely,

BRIAN BURKE
Senate Chair

SCOTT JENSEN
Assembly Chair

BB/SJ/jc

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JOINT COMMITTEE ON FINANCE

MEMORANDUM

To: Members
Joint Committee on Finance

From: Senator Brian Burke
Representative Scott Jensen
Co-Chairs, Joint Committee on Finance

Date: March 3, 1997

Re: 14 Day Passive Review of the Attached Department of Revenue Report on Lottery Sales

Attached please find a copy of a report from the Secretary of Revenue concerning state lottery sales pursuant to s. 565.02(7), Stats. The Secretary is required to report this information by March 1 every year.

Please review these materials and notify **Senator Burke's** or **Representative Jensen's** office no later than **Thursday, March 20, 1997** if you have any concerns about the report or would like the Committee to meet formally to discuss it.

BB:SJ:jc

State of Wisconsin ● **DEPARTMENT OF REVENUE**

125 SOUTH WEBSTER STREET ● P.O. BOX 8933 ● MADISON, WISCONSIN 53708-8933 ● (608) 266-6466 ● FAX (608) 266-5718

Tommy G. Thompson
Governor

Cate Zeuske
Secretary of Revenue

February 28, 1997

Representative Scott Jensen, Co-chair
Joint Committee on Finance
Room 315 North, State Capitol
Madison, WI 53703

Senator Brian Burke, Co-chair
Joint Committee on Finance
MLKB, Lower Level 1
Madison, WI 53708

Dear Representative Jensen and Senator Burke,

Section 565.02(7), Wis. Stats., requires a report to the Joint committee on Finance every March 1, containing the following information:

1. An estimate for the current and subsequent fiscal years of gross revenues from the sales of lottery tickets;

2. The total amount paid as prizes and the prize payout ratio for each type of lottery game offered, based on these sales estimates; and

3. An evaluation of the effect of prize payout ratios of lottery games on lottery sales, lottery operating costs and on maximizing the revenue available for lottery property tax relief.

The required report for 1997 is attached. It provides information suggesting that increases in prize payout ratios positively impact lottery sales. The Department of Revenue will use the findings of this report, and those of an upcoming report by the Legislative Audit Bureau, in developing a comprehensive plan to maximize lottery sales and property tax relief. We look forward to sharing our recommendations with you in the near future.

I would be happy to answer any questions you may have regarding this report.

Sincerely,

Cate Zeuske
Secretary of Revenue

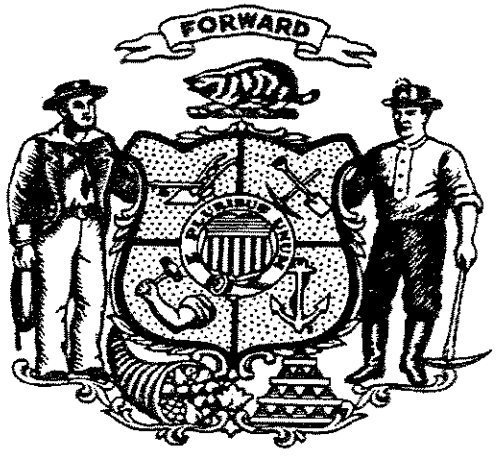
LOTTERY SALES AND PRIZE PAYOUT REPORT

REPORT TO THE JOINT COMMITTEE ON FINANCE

PREPARED BY:

DIVISION OF LOTTERY
WISCONSIN DEPARTMENT OF REVENUE

February 28, 1997



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A. HISTORY

The maximum average payout percentage that the Lottery can offer is subject to approval by the Legislature's Joint Committee on Finance. Section 565.02(7), Wis. Stats., requires a report by the Lottery to the Joint Committee on Finance every March 1, containing the following information:

A. An estimate, for fiscal years 1996-97 and 1997-98, of gross revenues from the sales of lottery tickets;

B. The total amount paid as prizes and the prize payout ratio for each type of lottery game offered, based on these sales estimates; and

C. An evaluation of the effect of prize payout ratios of lottery games on lottery sales, lottery operating costs and on maximizing the revenue available for lottery property tax relief.

In the first year of Lottery operation, FY1988-89, instant scratch and pulltab ticket prize payouts averaged about 50%. In the second year of operation the Lottery Board introduced the first on-line game, Lotto America, with a payout of 45% and increased average instant scratch and pulltab payouts to 60%. Between FY1989-90 and FY1993-94, average instant scratch payouts increased by about 1%, while average instant pulltab payouts remained constant. Average on-line payouts have remained about 50% since FY1991-92.

In May 1994 the Wisconsin Gaming Commission submitted the first Prize Payout Report to the co-chairs of the Joint Committee on Finance. Following a hearing on that report, the committee authorized an increase in the average instant scratch ticket prize payout from about 61% to 63% and an increase in the average instant pulltab ticket prize payout from about 60% to 62%. Average on-line ticket prize payouts went unchanged. Subsequent reports in March 1995 and 1996 did not seek to increase the instant or on-line prize payout rates.

Currently, there is not an explicit limit on the average prize payout for on-line games similar to what exists for instant games. The average prize payout across all on-line games is roughly 50% and ranges between 45.1% and 53.5%. The average rate is set at 50%, with a maximum of 53.5%. This range may not be appropriate for future games the lottery may develop. Further study on the overall impact to sales and net proceeds is warranted.

Governor Thompson's budget proposes additional funding to launch new or enhanced on-line games. High top-prize and jackpot on-line games with correspondingly low payout rates (such as Supercash, Daily Millions, Powerball and Megabucks) will continue to be a primary on-line product. However, future growth in the on-line market is anticipated to be among games similar to instant

games, offering lower top prizes and correspondingly better odds and higher payouts. It is envisioned that these games will capture the success of instant games in the on-line market.

B. GROSS REVENUES FROM LOTTERY SALES (FY 1993-94 through FY 1997-98)

Table 1 shows sales by game type for the past three years and projected sales for the next two years. Total lottery sales peaked in FY 1994-95, reaching almost $519 million and representing a 4.7% increase from the previous year. The increase in sales in FY1994-95 was due entirely to a 13.4% increase in sales of instant scratch games. Both pulltab and on-line sales declined in that year. In FY 1995-96 sales in all three product lines declined, and declines are projected through FY 1997-98.

Table 1

Ticket Sales by Fiscal Year and Game Type

Game Type	FY 1993-94 Sales Audited	FY 1994-95 Sales Audited	FY 1995-96 Sales Unaudited	FY 1996-97 Sales Estimate	FY 1997-98 Sales Projection
Instant Scratch	$273,730,130	$310,313,556	$302,207,252	$287,500,000	$267,560,000
Instant Pulltab	$11,587,320	$10,042,539	$8,194,440	$7,500,000	$8,830,000
On-line	$210,203,461	$198,558,875	$171,722,228	$165,000,000	$164,010,000
Total	$495,520,911	$518,914,970	$482,123,920	$460,000,000	$440,400,000

note: FY 1997-98 sales projections reflect proposals in the Governor's 1997-99 budget that are intended to increase sales.

Exhibits 1 through 4 are graphical representations of Lottery sales.

C. TOTAL PRIZE PAYOUT RATIOS AND PRIZES PAID OR EXPECTED TO BE PAID (FY 1993-94 through FY 1997-98)

Table 2 shows the weighted average prize payouts by game type estimated for the next two fiscal years, as well as the amounts in the past three fiscal years. A weighted average is used to attribute more importance to games with higher sales, instead of giving all games equal consideration. The prize payout percentage is the average amount of the game's cost that is returned to players in the form of prizes. The game's prize structure is used to determine its prize payout percentage. Each individual game has a unique prize structure that represents the number, value and odds of winning each prize in that game. Exhibit 5 identifies the game design prize payout percentages for current Lottery games.

Table 2

Weighted Average Prize Payout Percentages by Fiscal Year and by Game Type
(percentages are rounded)

Game Type	FY 1993-94 Prize Payout	FY 1994-95 Prize Payout	FY 1995-96 Prize Payout	FY 1996-97 Prize Payout Estimate	FY 1997-98 Prize Payout Projection
Instant Scratch	61.40%	62.86%	62.97%	63.00%	63.00%
Instant Pulltab	60.30%	60.30%	61.96%	62.00%	62.00%
On-line	50.83%	50.67%	50.62%	50.34%	50.37%

Table 3 shows actual prizes paid during the past three fiscal years and expected prizes to be paid in the next two fiscal years. Expected prizes to be paid in FY1996-97 and FY1997-98 are calculated simply as the projected sales given in Table 1 multiplied by the designed prize payout percentages given in Table 2.

Table 3

Actual Prizes Paid or Expected to be Paid by Fiscal Year and by Game Type

Game Type	FY 1993-94 Prizes Paid (Audited)	FY 1994-95 Prizes Paid (Audited)	FY 1995-96 Prizes Paid (Unaudited)	FY 1996-97 Expected Prizes (rounded)	FY 1997-98 Projected Prizes (rounded)
Instant Scratch	$166,950,503	$194,253,050	$189,609,111	$181,130,000	$168,560,000
Instant Pulltab	$6,990,948	$6,098,868	$5,003,653	$4,650,000	$5,470,000
On-line	$99,748,968	$98,465,571	$82,330,739	$83,060,000	$82,610,000
Total	$273,690,419	$298,817,489	$276,943,503	$268,840,000	$256,640,000

D. EVALUATION OF PRIZE PAYOUT RATIOS

There appears to be industry-wide agreement that to some extent increased prize payouts for instant games lead to increased sales. However, there are differing expectations in the amount of net proceeds produced from such a change. Because of this uncertainty on net proceeds, further review should be performed before any change in the prize payout ratio is suggested. An initial analysis by lottery staff suggests that an increase would not significantly benefit the amount of money available for property tax relief.

As previously stated, an analysis should also be performed relating to any change in the on-line prize payout rate.

The view in the lottery industry that an increase in the prize payout ratio will increase sales of instant games is based on the belief that behavior changes when players have more frequent "winning" experiences. There are mixed results on the impact of higher prize payouts on net revenue. As the payout rate increases, a lower percentage of each sale is available to cover administrative costs, including retailer compensation. In order for net revenues to increase, the increase in sales must be large enough to offset the increased cost of the higher payout rate. Prize payout is one of many factors, such as advertising, the number and type of game launches, game themes and playstyles, and market competition that may lead to increased sales.

Last year's Prize Payout Report included examples of other jurisdictions (Colorado, Massachusetts, Ohio, Arizona and Kentucky) that increased their prize payout rates and experienced increases in sales and net proceeds. In all cases but one, the increased ratios they implemented were from fairly low prize payouts to payouts closer to the industry average. Wisconsin's average payout is still currently among the upper half of lotteries nationwide. Included in this report as Appendices 6-9 are updated examples from these states. Massachusetts did not provide updated information.

These states used other activities to increase sales in conjunction with increased prize payouts which may have contributed to increased sales. For example, Colorado implemented a nine-step program, which included an increase in prize payout. Other actions included full on-line instant ticket validation and removal of guaranteed low-end prize structure accounting.

Table 4 lists the instant prize payout rates from CY1993 to FY1996-97 of 32 lottery jurisdictions in the United States. The data come from various surveys performed by La Fleur's, an organization that provides basic lottery information to the lottery industry and the public. The averages at the bottom of Table 4 indicate a steady trend among jurisdictions toward increasing the instant payout rate over time. Table 4 indicates that 12 lottery jurisdictions plan to increase their prize payout rates in FY1997. Seven of those 12 jurisdictions will still have FY1996-97 average payouts below Wisconsin's current 63% average instant payout rate.

A recent public study[1] on the issue of prize payouts and their impact on sales and net proceeds was performed by John Mellein of the Washington State Lottery and presented at the World Meet '96 lottery conference in Vancouver. His analysis finds that higher prize payouts are correlated with higher per capita spending. Mellein does not have data on net revenues, but he recognizes the fact that higher payouts necessarily imply a lower percentage return of total sales. However, Mellein argues that the increased sales volume will make up for the increased cost of higher payouts. The industry example, and the primary example used by Mellein, is that of Massachusetts, which has been an industry leader for many years in high payout rates and correspondingly high per capita spending. Table 4 indicates that Massachusetts is planning to raise its average instant prize payout in FY1996-97, which seems to indicate that Massachusetts

[1] According to Brian McCarthy of the Connecticut Department of Revenue (formerly with the Connecticut Lottery), the Connecticut Lottery has performed a great deal of research on the issue of prize payouts and other measures to increase sales. Connecticut's instant prize payouts currently average 65%. These studies are not publicly available, but, according to McCarthy, the prize payout is one measure among several important measures such as game-specific advertising, dual launches, increased number of launches and multiple price point launches that have contributed to increased sales in Connecticut over the last several years.

believes that its instant payout rate has further room to increase before net revenues are negatively impacted.

Table 4

Prize Payout Percentages of Instant Scratch Games Across Lottery Jurisdictions

Lottery Jurisdiction	CY1993 Prize Payout	FY1994-95 Prize Payout	FY1995-96 Prize Payout (projection) /1	FY1996-97 Prize Payout (projection) /1	Jurisdictions Increasing Payout in FY1997
AZ	48	55	58.1	55-58	
CA	50	50	50	51	yes
CO	65	65	65	65	
CT	65	65	65	67.5	yes
DC	63.9		62.4		
DE	57.5	58	59.3	59.7	yes
FL	57	55	57.5	57.5	
IA	61	62	62.1	62	
ID	63	64	64.7	66	yes
IL	58.4	58	58.5	58-60	yes
IN	59.5	60	59.5	59.5	
KS	54	59	58.6	58	
KY	65	64	63.8	63.2	
MA	68	70	70	72	yes
MD	58	60	62		
ME	59	60	60	61	yes
MI	55	55	58	59	yes
MN	63.5	66	66.7	67	yes
MO	55	56	56	56	
MT	54	55	55	58	yes
NH	63	63	63	63	
NJ	50	55	60	60	
NY	55	55	55	55	
OH	60	58	61.5	61.5	
OR	63	65	65	65	
PA	55	56	56.4	57	yes
SD	60	54	62.5	62.5	
VA	55	56	55.4	55.4	
VT	58	62	62	61	
WA	60	62	62	64	yes
WI	61	63	63	63	
WV	60	60	60	60	
Average	**58.7**	**59.5**	**60.6**	**60.8**	**12 Jurisdictions**

source: La Fleur's Lottery World Magazine, July 1994, July 1995, July 1996. No data provided for CY1994 or FY1993-94.
Note: Payout rates may under- or overstate actual rates since some states include TV game show prizes, free tickets and unclaimed prizes in the calculation of the reported payout rate, but other states do not. Wisconsin is prohibited from providing free tickets, and it does not use unclaimed prizes to fund instant prize payouts, but it does include TV show prizes in the calculation of instant prize payout rates. 1/ FY1995-96 and FY1996-97 prize payouts are projected as La Fleur's collected data mid-year FY1995-96.

The underlying data of Mellein's study is shown in Table 5. The data are the same as in Table 4, since they also come from La Fleur's. Table 5, however, includes per capita spending in addition to prize payouts. The last two columns present the increase in prize payouts and per capita spending across 32 lottery jurisdictions between CY1993 and FY1995-96. Jurisdictions in Table 5 are ranked by the increase in prize payout between CY1993 and FY1995-96 (column 6). Although there is much variation in the data, the average payout increased 1.8 percentage points and per capita spending increased on average $20.20.

Despite the apparent correlation between prize payouts and per capita spending, it is difficult to interpret the true impact of some of the data in Mellein's study. For example, although Wisconsin appears to have had no increase in per capita spending after a 2% increase (from 61% to 63%) in prize payout, in FY1994-95 Wisconsin experienced an increase of $7.18 [2] in per capita spending compared to FY1993-94. Thus, the data as presented may be misleading in terms of the effect of increasing a prize payout ratio.

[2] FY94 Instant Scratch = $273.7 million. FY95 Instant Scratch = $310.3. Difference = $36.6 million. Based upon 5.1 million population, this implies $7.18 increase in per capita spending.

Table 5

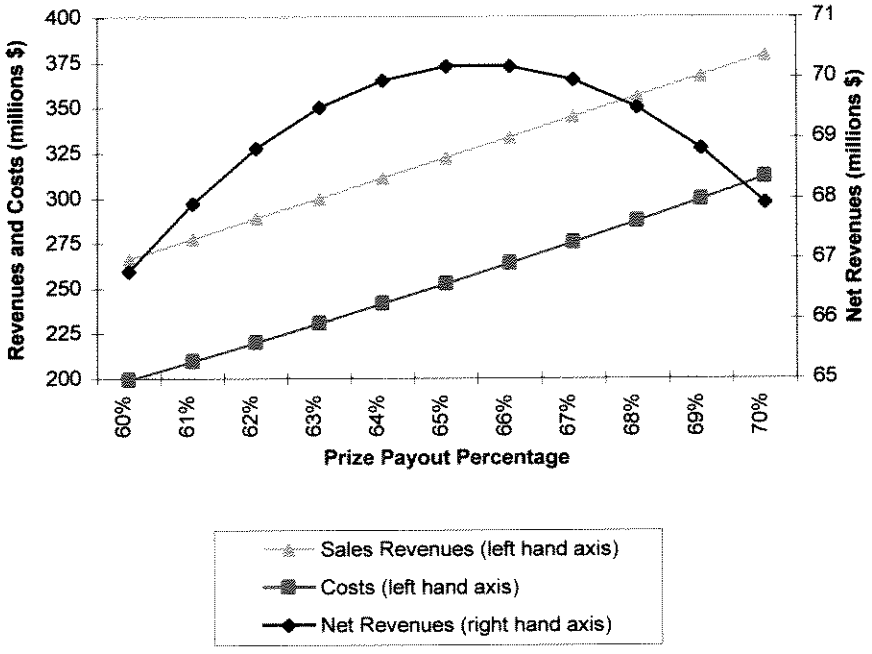
Instant Scratch Prize Payout Rates and Per Capita Spending Across U.S. Lottery Jurisdictions, CY1993 & FY1995-96

Lottery Jurisdiction	CY1993		FY1995-96		Changes CY1993 - FY1995-96	
	Prize Payout (percent)	Per Capita Spending ($)	Prize Payout (percent)	Per Capita Spending ($)	Prize Payout (percent)	Per Capita Spending ($)
AZ	48.0	17	58.1	21	10.1	4
NJ	50.0	22	60.0	43	10.0	21
KS	54.0	15	58.6	33	4.6	18
VT	58.0	48	62.0	95	4.0	47
MD	58.0	22	62.0	37	4.0	15
MN	63.5	49	66.7	59	3.2	10
MI	55.0	30	58.0	50	3.0	20
SD	60.0	14	62.5	20	2.5	6
MA	68.0	244	70.0	329	2.0	85
OR	63.0	17	65.0	44	2.0	27
WI	**61.0**	**59**	**63.0**	**59**	**2.0**	**0**
WA	60.0	14	62.0	31	2.0	17
DE	57.5	28	59.3	34	1.8	6
ID	63.0	28	64.7	58	1.7	30
OH	60.0	71	61.5	109	1.5	38
PA	55.0	18	56.4	32	1.4	14
IA	61.0	35	62.1	34	1.1	-1
ME	59.0	52	60.0	82	1.0	30
MO	55.0	22	56.0	37	1.0	15
MT	54.0	11	55.0	8	1.0	-3
FL	57.0	33	57.5	43	0.5	10
VA	55.0	40	55.4	43	0.4	3
IL	58.4	37	58.5	55	0.1	18
CO	65.0	34	65.0	50	0.0	16
CT	65.0	30	65.0	90	0.0	60
NH	63.0	49	63.0	85	0.0	36
WV	60.0	26	60.0	42	0.0	16
IN	59.5	36	59.5	59	0.0	23
NY	55.0	16	55.0	56	0.0	40
CA	50.0	14	50.0	19	0.0	5
KY	65.0	73	63.8	76	-1.2	3
DC	63.9	28	62.4	45	-1.5	17
Average	**58.7**	**38.5**	**60.6**	**58.7**	**1.8**	**20.20**
Average for jurisdictions that raised their payout rate					**2.6**	**18.70**
Average for jurisdictions that didn't raise their payout rate					**- 0.3**	**24.00**

Source: La Fleur's Lottery World Magazine, July 1994, July 1995, July 1996.
Note: Payout rates may under- or overstate actual rates since some states include TV game show prizes, free tickets and unclaimed prizes in the calculation of the reported payout rate, but other states do not. Wisconsin is prohibited from providing free tickets, and does not use unclaimed prizes to fund instant prize payouts, but it does include TV show prizes in the calculation of instant prize payout rates.
1/ FY1995-96 prize payouts are projected, as La Fleur's collected the data mid-year FY1995-96.

Chart 1 demonstrates the impact an increase in the prize payout ratio may have in Wisconsin. It depicts estimated sales revenues, costs and net revenues at different prize payout rates. Sales revenues are estimated to increase as the prize payout rate increases, but costs are estimated to increase as well. Costs increase for two reasons. First, higher sales result in higher commissions paid to retailers. Commissions are constant as a percent of sales (5.5%). As sales increase, so do most operating costs. Second, the increased payout ratio means that a higher percentage of sales is allocated to prizes, leaving a smaller balance from which to pay expenses and provide property tax relief.

Chart 1
Sales Revenues, Costs, and Net Revenues at Different Prize Payout Rates



It appears in Chart 1 as though revenues and costs increase at the same rate. However, the scale of the chart hides the true relationship between the two, which is shown by the net revenues curve. Net revenues are calculated as the difference between sales revenues and costs. Chart 1 shows that given the assumptions of the model and based upon the experiences of other states, net revenues from instant tickets in Wisconsin peak around an instant payout rate of 66%. At payout rates above 66%, instant net revenues are estimated to decline. At payout rates above 66%, costs increase more than revenues, resulting in lower net revenues than achieved at a 63% payout rate.

Table 6 depicts a numerical view of the revenue and cost estimates used to create Chart 1. In the table, prize expense is separated into three categories to more clearly depict the influence of changes to the payout structure. Assuming a sales base of $300 million, the first category is the prize expense on the original $300 million in sales at 63% payout, or $189 million. The second category is the additional prize expense on the base $300 million that results from the higher payout rate. For example, at a payout of 64%, the Lottery pays an additional $3 million in prizes on the original $300 million in sales. The third category is the prize expense on the incremental sales above $300 million. Raising the prize payout ratio to 64% is estimated to generate an additional $11.3 million in sales, resulting in $7.2 million in additional prize expenses.

Table 6
Hypothetical Cost-Benefit Analysis of Changing the Prize Payout Ratio
(in millions)

	63%	64%	65%	66%	67%	68%	69%
Sales Revenues	$300.0	$311.3	$322.6	$334.0	$345.3	$356.6	$367.9
Costs							
Retailer commissions	16.5	17.1	17.7	18.4	19.0	19.6	20.2
Fixed costs	25	25	25	25	25	25	25
Cat. 1 Prize cost at 63% on all sales up to $300 million.	189	189	189	189	189	189	189
Cat. 2 Prize cost of increased payout rate on original sales of $300 million.	0	3.0	6.0	9.0	12.0	15.0	18.0
Cat. 3 Prize cost on additional sales above $300 million due to increased payout rate	0	7.2	14.7	22.4	30.4	38.5	46.9
Total Cost of Prizes	$189.0	$199.2	$209.7	$220.4	$231.4	$242.5	$253.9
Total Costs	$230.5	$241.4	$252.5	$263.8	$275.3	$287.1	$299.1
Net Revenues	$69.5	$70.0	$70.2	$70.2	$70.0	$69.5	$68.8

These numbers are used for illustrative purposes only and should not be used for other estimates.

Based on this evaluation by the Lottery Division, raising the prize payout rate on instant games may not result in increased net proceeds, though an increase in instant sales is likely.

On-line Games and the Prize Payout Ratio

As mentioned, the maximum payout percentage that the Lottery can offer is subject to approval by the Legislature's Joint Committee on Finance. Currently, on-line prize payout ratios average 50% and range between 45.1% and 53.5%. Statutory provisions require that at least 50% of gross sales be returned to players as prize payments (s. 25.75(3)(a), Wis. Stats.). Table 7 lists the on-line games and associated prize payouts that have been offered to date in Wisconsin.

When evaluating the prize payout ratios, the on-line games are looked at apart from instant and pulltab games. With the exception of Daily Millions, the Lottery's current on-line games are mature and may be exhibiting declining player interest. Exhibits 10 and 11 compare sales per game draw to jackpot size of Powerball and Megabucks. Both charts demonstrate a reduction in player interest because sales at each jackpot level have declined from the previous year. Exhibit 12 shows weekly per capita sales of Supercash since the game began. This chart also indicates declining player interest.

TABLE 7
On-Line Games and Corresponding Start Dates and Prize Payout Rates

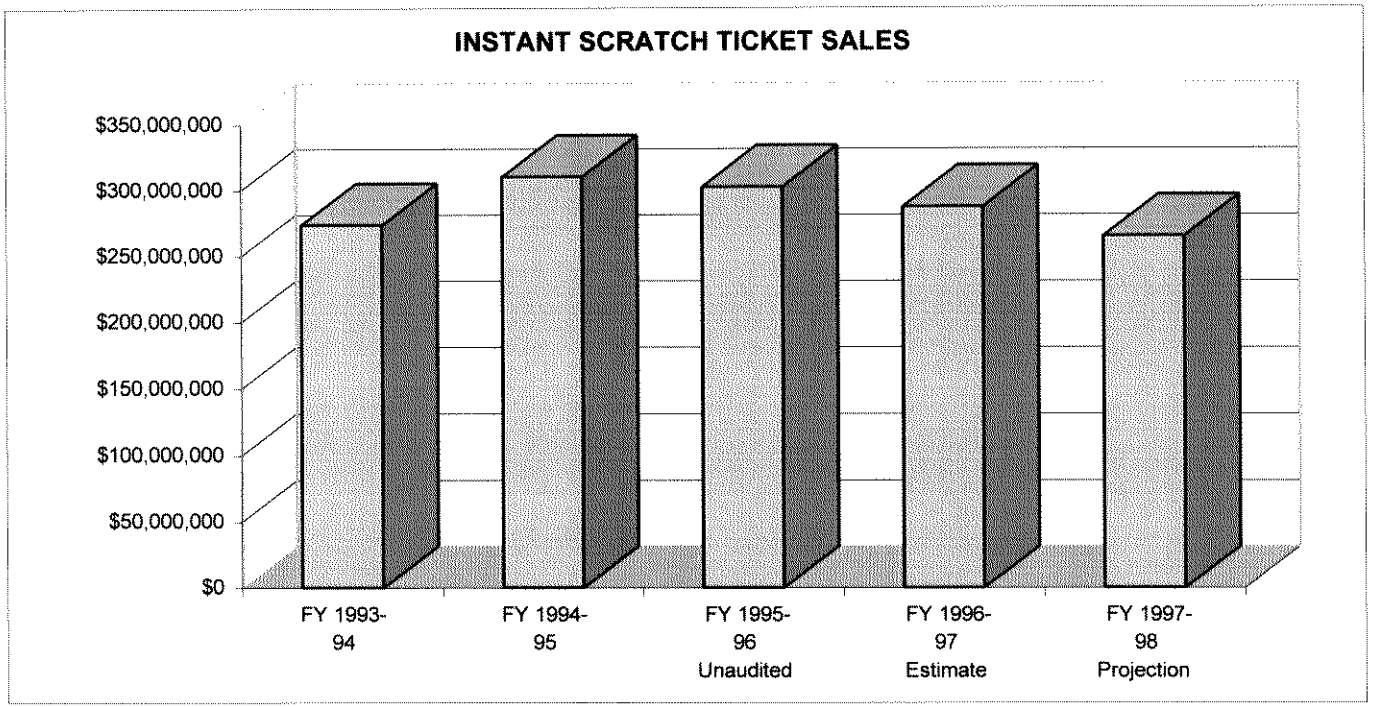
ON-LINE GAMES		START DATE	PAYOUT	END DATE
LOTTO AMERICA		8/10/89	45.0%	4/18/92
SUPERCASH		2/04/91	51.60%	
POWERBALL		4/19/92	Approx 50.00%	
WISCONSIN'S VERY OWN MEGABUCKS		6/18/92	53.50%	
Pick 3	straight	9/21/92		
Pick 3	3 way box		48.20%	
Pick 3	6 way box			
MONEY GAME 4		9/13/93	47.00%	8/03/96
DAILY MILLIONS		9/16/96	45.10%	

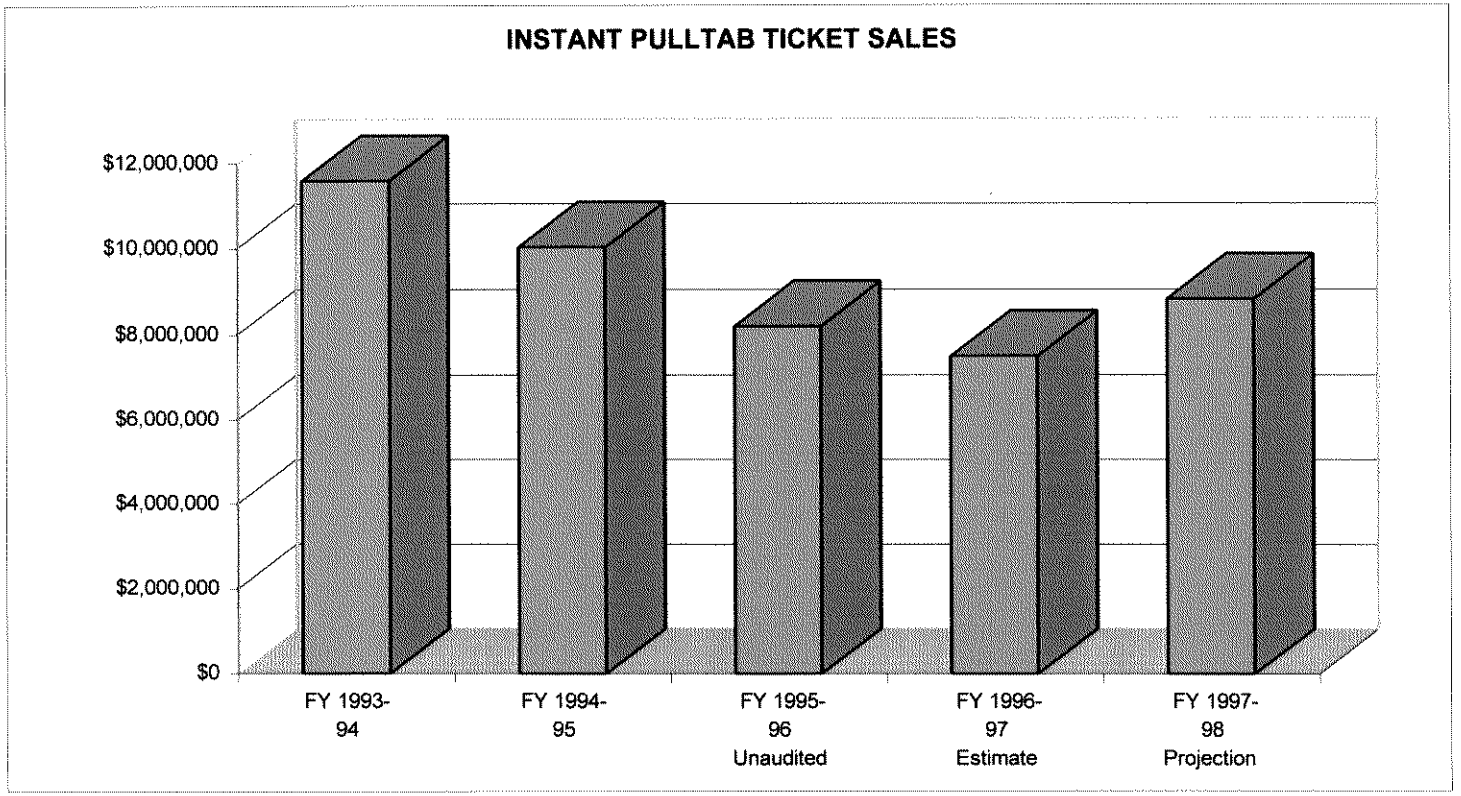
The argument is made that high prize payout ratios are unnecessary for on-line games since they rely on high top prizes and jackpots to maintain player interest. The argument is probably accurate for jackpot games such as Powerball and Megabucks, but the industry envisions creating new on-line games that are similar to instant games, capturing the success of instant games in the on-line

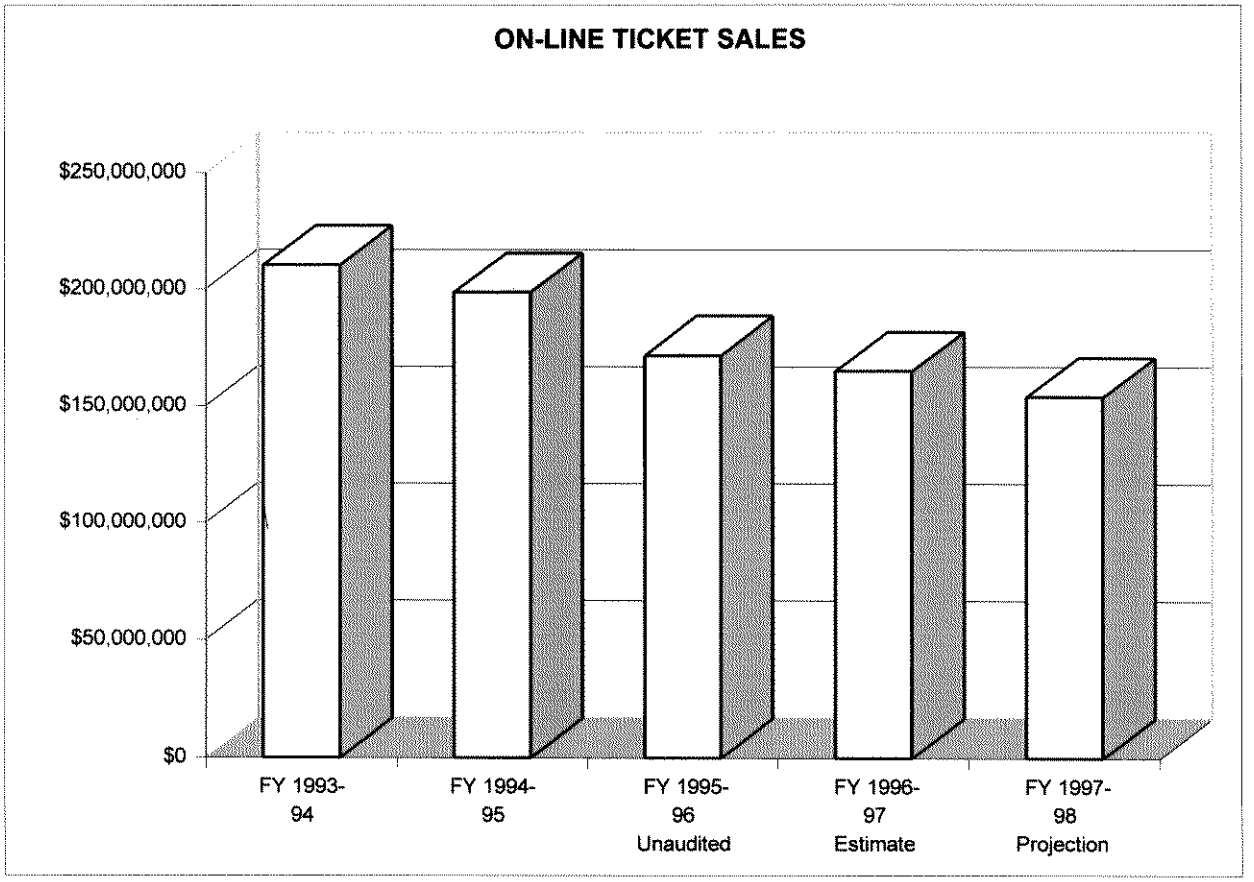
market. Games with high top prizes will still be a primary on-line product. New games with multiple draws each day and top prizes ranging between $10,000 and $50,000 will be the new area of growth.

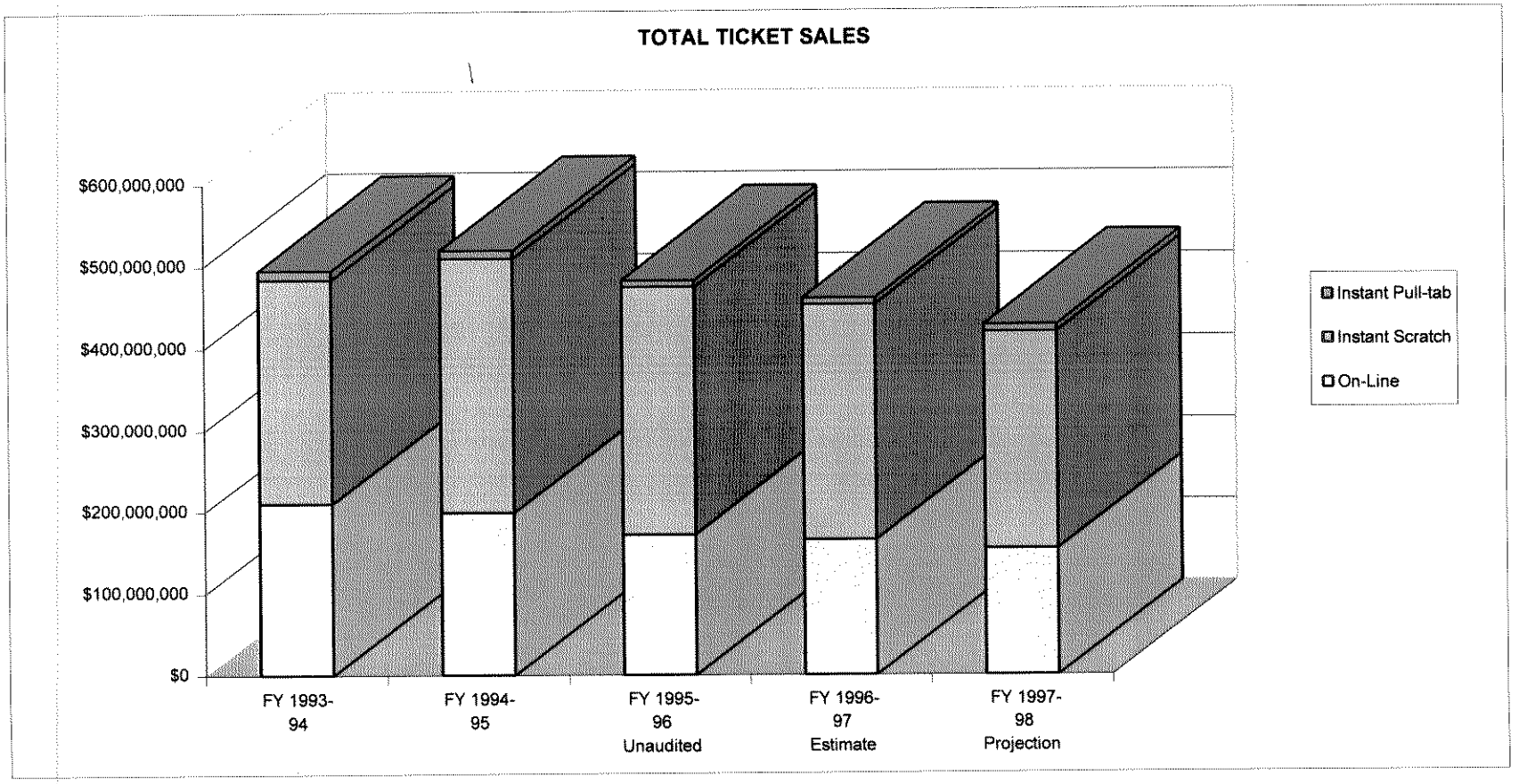
Since new styles of on-line games have yet to be introduced, the impact on sales and net revenues in unknown. It is expected that the new style of games will add to sales revenues due to their novelty. In addition, the transfer of sales from other on-line games is not expected to be high because of the different game styles of the products. While Pick 3 is a low top prize game with a comparatively low payout rate of 48.2%, it has a long established and specialized player base, which is unlikely to migrate from that game. However, this is more of an anomaly and the belief throughout the industry is that in the absence of a high top prize, a higher payout rate is necessary to keep the players in the game.

While the department is not recommending specific changes at this time, we believe this report and an upcoming audit report of the Lottery by the Legislative Audit Bureau will prove useful in developing a broad strategy for increasing lottery sales. We would appreciate the opportunity at a later date to present the Joint Finance Committee with a specific, comprehensive plan to improve property tax relief for the citizens of Wisconsin.


INSTANT SCRATCH TICKET SALES
$350,000,000
$300,000,000
$250,000,000
$200,000,000
$150,000,000
$100,000,000
$50,000,000
$0
FY 1993-94
FY 1994-95
FY 1995-96 Unaudited
FY 1996-97 Estimate
FY 1997-98 Projection


INSTANT PULLTAB TICKET SALES
$12,000,000
$10,000,000
$8,000,000
$6,000,000
$4,000,000
$2,000,000
$0
FY 1993-94
FY 1994-95
FY 1995-96 Unaudited
FY 1996-97 Estimate
FY 1997-98 Projection


ON-LINE TICKET SALES
$250,000,000
$200,000,000
$150,000,000
$100,000,000
$50,000,000
$0
FY 1993-94
FY 1994-95
FY 1995-96 Unaudited
FY 1996-97 Estimate
FY 1997-98 Projection


TOTAL TICKET SALES
$600,000,000
$500,000,000
$400,000,000
$300,000,000
$200,000,000
$100,000,000
$0
FY 1993-94
FY 1994-95
FY 1995-96 Unaudited
FY 1996-97 Estimate
FY 1997-98 Projection
Instant Pull-tab
Instant Scratch
On-Line

PRIZE PAYOUT PERCENTAGES
FOR CURRENT WISCONSIN LOTTERY GAMES

Instant Scratch Games

Game	Price Point	Start Date	Prize Payout
Vacation Moola*	$1	04/26/93	64.91%
American Moola	$1	06/21/93	63.79%
Spin N' Win*	$1	07/12/93	60.03%
Money Game Moola*	$1	08/30/93	62.55%
Little Scratch Bingo	$2	01/30/95	61.17%
Double Blackjack*	$1	02/13/95	66.12%
Ace in the Hole	$1	05/01/95	60.89%
Instant Scratch Lucky Match	$5	05/15/95	63.17%
Magic Hats*	$5	05/15/95	63.17%
3 of a Kind	$1	06/19/95	61.06%
Lucky Dog	$1	07/17/95	60.06%
The Big Game	$2	08/07/95	60.35%
First and Ten	$1	08/28/95	60.78%
Cash Harvest	$1	09/11/95	69.13%
Little Scratch Bingo Bucks	$2	09/18/95	63.00%
Instant Scratch Bingo Bucks	$5	09/18/95	62.57%
Let it Roll 7-11	$1	10/02/95	61.00%
Winning Hand	$1	10/02/95	60.89%
Bank Shot	$1	10/23/95	61.06%
Slap Shot	$1	10/23/95	60.99%
Tic Tac Toe Doubler	$1	11/06/95	67.76%
Double Doubler*	$1	11/06/95	61.28%
Jingle Bell Cash	$5	11/27/95	66.88%
Big Lucky 7's	$2	12/11/95	63.04%
Cold Cash	$1	12/11/95	60.89%
Return of Couch Potato Doubler*	$1	01/08/96	66.00%
Royal Flush	$1	01/29/96	60.90%
Cash Blast	$1	02/19/96	68.31%
Big Roll	$2	03/11/96	62.02%
High Card Doubler	$1	03/25/96	61.03%
Payday	$1	04/15/96	60.97%
Cash Vault	$1	04/15/96	64.36%
Scratchin' To Win	$1	05/06/96	60.97%
Deuces Wild	$1	05/06/96	61.00%
Wild 7's	$2	05/20/96	64.83%
Double Header	$1	06/03/96	61.03%
Heat Wave	$1	06/24/96	61.10%
Goin' For The Green	$1	07/15/96	61.03%
In-Between	$1	08/05/96	60.97%
Bull's Eye Tripler	$1	08/26/96	61.03%
Wind Fall	$1	09/23/96	61.06%
Gold Rush	$1	12/20/96	68.31%
Casino Slots	$1	01/27/97	61.79%
Gold Mine	$1	02/10/97	68.60%
Lucky Leprechaun	$2	02/17/97	62.12%

* Tickets sold out; game ended on 11/16/96, last day to pay prizes is 5/15/97.

PRIZE PAYOUT PERCENTAGES
FOR CURRENT WISCONSIN LOTTERY GAMES

Pulltab Games

Game	Start Date	Prize Payout
Badger Cash	07/06/90	60.00%
Luck of the Draw	06/01/92	60.00%
Football	10/24/94	62.94%
Cherry Bell	05/16/96	61.96%
Casino Gold II	05/16/96	61.96%
Old Glory	06/06/96	61.96%
3 In A Row	06/06/96	61.96%
Lucky 7's	06/27/96	61.96%

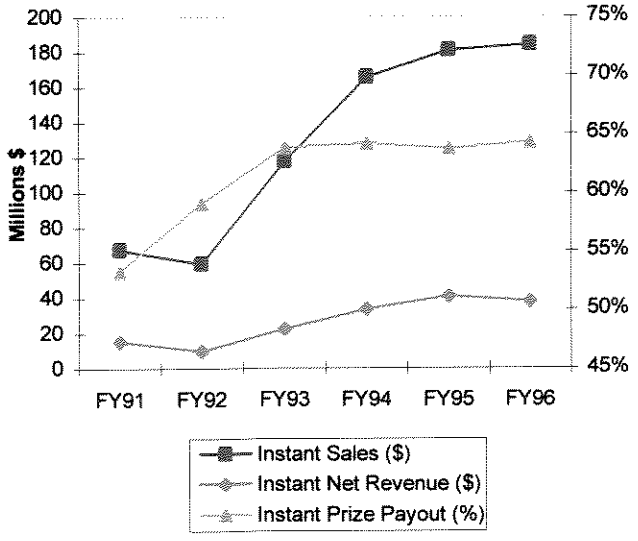
On-Line Games

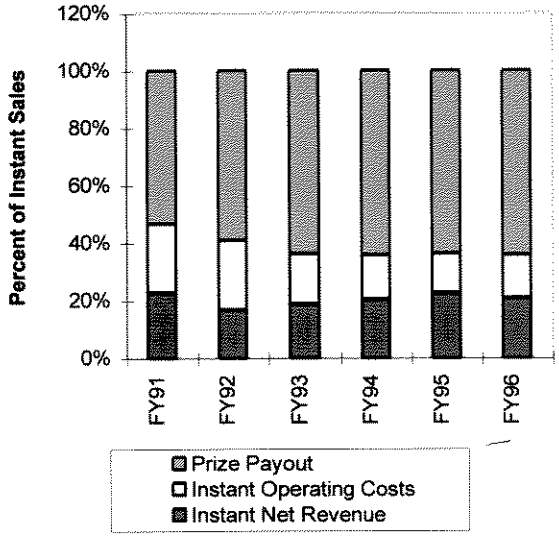
Game	Start Date	Prize Payout
Supercash!	02/04/91	51.6%
POWERBALL®	04/19/92	50.0%
Wisconsin's Very Own Megabucks	06/18/92	53.5%
Daily Pick 3	09/21/92	48.2%
Daily Millions	09/16/96	45.14%

COLORADO LOTTERY

Impact of Increase in Prize Payout on Gross Instant Scratch Product Sales & Net Proceeds

YEAR	Instant Sales (millions $)	Net Proceeds (millions $)	Percent of Instant Sales: Prize Payout	Operating Cost	Net Proceeds
FY91	67.1	15.1	53.30%	24.14%	22.56%
FY92	59.3	9.9	59.10%	24.24%	16.66%
FY93	117.6	22.1	63.80%	17.43%	18.77%
FY94	165.6	33.5	64.20%	15.58%	20.22%
FY95	180.9	40.6	63.70%	13.84%	22.46%
FY96	184.1	38.0	64.30%	15.07%	20.63%
$ change (FY91-96)	$117.0	$22.8			
% change (FY91-96)	174.4%	150.9%			





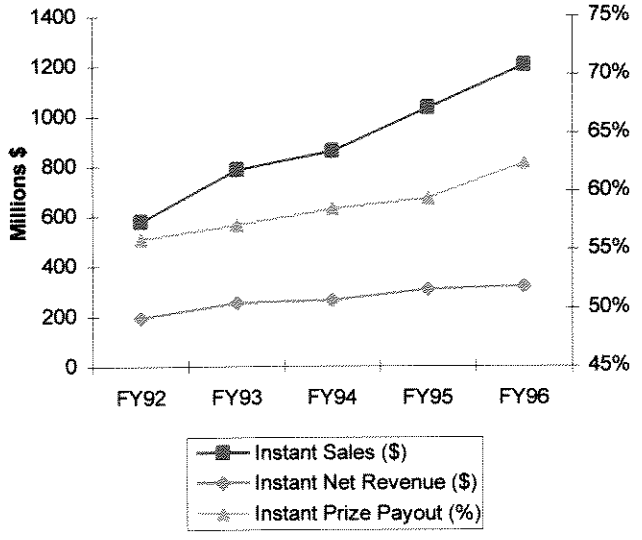
source: Greg Glazner, Colorado Lottery

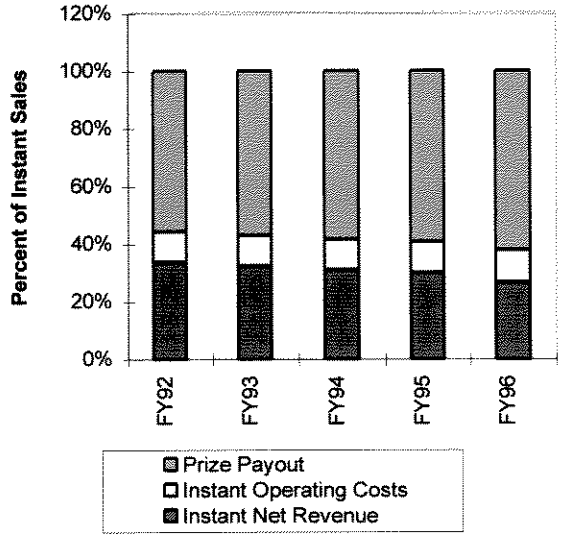
notes: 1) Net proceeds equal instant sales less instant prize payout less instant operating costs.
2) Operating costs equal ticket printing plus retailer commissions on instant ticket sales plus allocated administrative expenses.

OHIO LOTTERY

Impact of Increase in Prize Payout on Gross Instant Scratch Product Sales & Net Proceeds

YEAR	Instant Sales (millions $)	Net Proceeds (millions $)	Percent of Instant Sales: Prize Payout	Operating Cost	Net Proceeds
FY91					
FY92	577.7	193.6	55.90%	10.58%	33.52%
FY93	783.8	252.7	57.12%	10.64%	32.24%
FY94	857.9	264.3	58.45%	10.74%	30.81%
FY95	1031.6	306.6	59.40%	10.88%	29.72%
FY96	1204.4	318.9	62.40%	11.12%	26.48%
$ change (FY92-96)	$626.7	$125.3			
% change (FY92-96)	108.5%	64.7%			





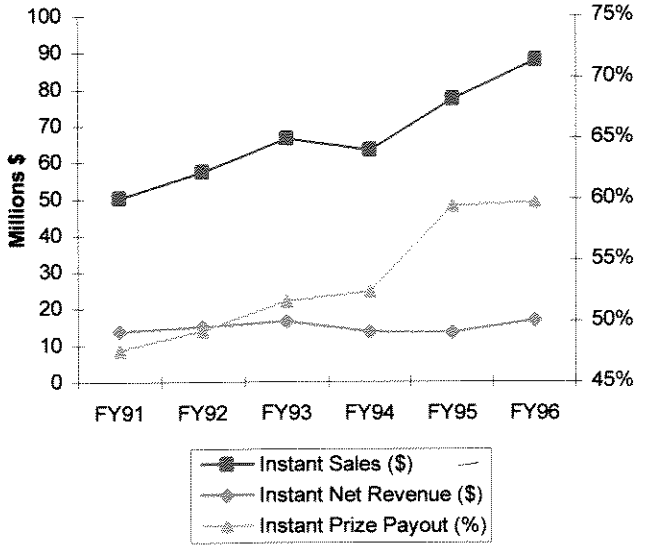
source: Dom Cipriano, Ohio Lottery

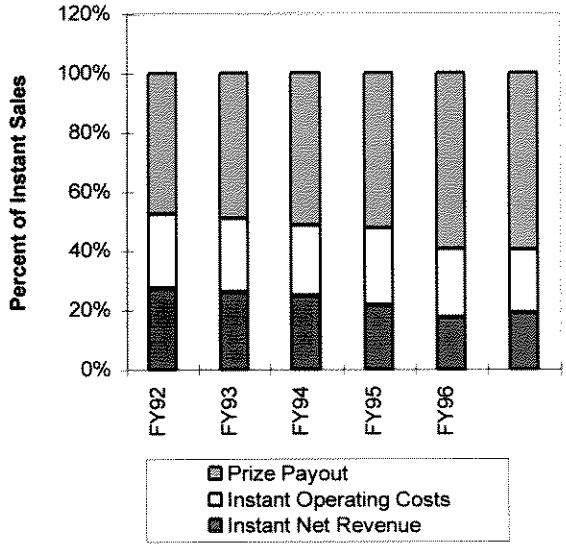
notes: 1) Net proceeds equal instant sales less instant prize payout less instant operating costs.
2) Operating costs equal 5% administrative costs plus retailer commissions from instant sales.
3) Administrative costs cover salaries, ticket printing, advertising and other costs associated with instant games -all estimated by the Ohio Lottery to be 5% of instant ticket sales. Administrative costs do not include free tickets, which account for 3-4% of ticket sales.

ARIZONA LOTTERY

Impact of Increase in Prize Payout on Gross Instant Scratch Product Sales & Net Proceeds

YEAR	Instant Sales (millions $	Net Proceeds (millions $	Percent of Instant Sales: Prize Payout	Operating Cost	Net Proceeds
FY91	50.1	13.7	47.60%	24.96%	27.44%
FY92	57.2	15.0	49.20%	24.66%	26.14%
FY93	66.4	16.5	51.60%	23.58%	24.82%
FY94	63.2	13.6	52.40%	26.06%	21.54%
FY95	77.2	13.4	59.40%	23.23%	17.37%
FY96	87.8	16.7	59.70%	21.29%	19.01%
$ change (FY91-96)	$37.7	$2.9			
% change (FY91-96)	75.2%	21.4%			





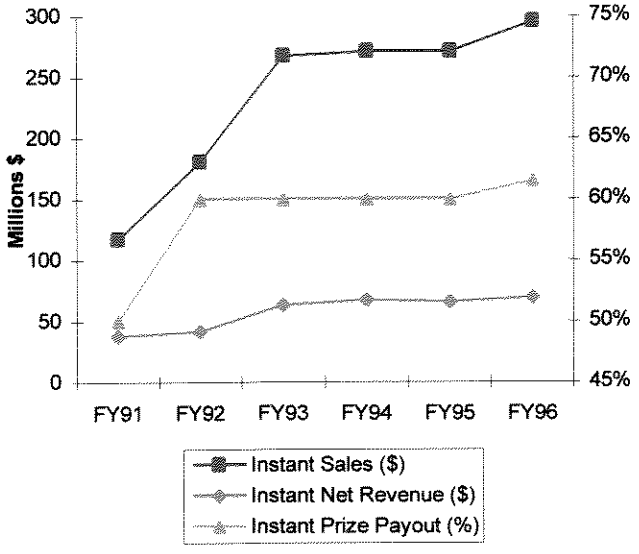
source: Graham Bennett, Arizona Lottery

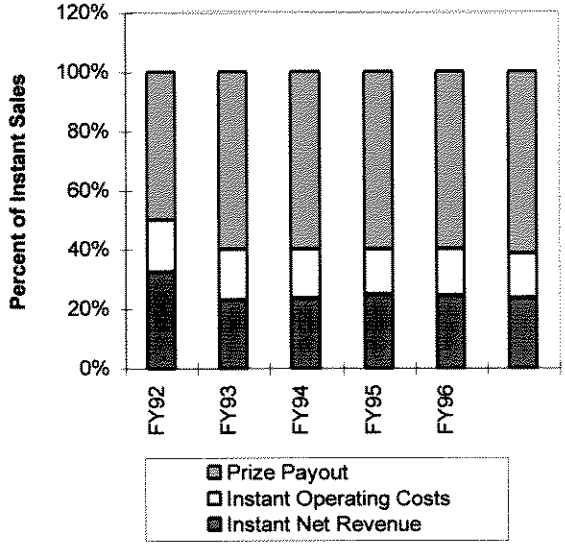
notes: 1) Net proceeds equal instant sales less instant prize payout less instant operating costs.
2) Operating costs equal ticket printing plus retailer commissions on instant ticket sales plus 50% of salaries, contract fees, and other administrative expenses plus 75% of product information costs.

KENTUCKY LOTTERY

Impact of Increase in Prize Payout on Gross Instant Scratch Product Sales & Net Proceeds

YEAR	Instant Sales (millions $)	Net Proceeds (millions $)	Percent of Instant Sales: Prize Payout	Operating Cost	Net Proceeds
FY91	116.5	37.7	50.00%	17.65%	32.35%
FY92	180.3	41.3	60.00%	17.09%	22.91%
FY93	267.1	62.9	60.00%	16.46%	23.54%
FY94	270.7	67.0	60.00%	15.26%	24.74%
FY95	270.7	65.6	60.00%	15.76%	24.24%
FY96	295.2	69.2	61.50%	15.07%	23.43%
$ change (FY91-96)	$178.7	$31.5			
% change (FY91-96)	153.4%	83.5%			





source: John Greenup, Kentucky Lottery

notes: 1) Net proceeds equal instant sales less instant prize payout less instant operating costs.
2) Operating costs equal ticket printing plus retailer commissions on instant ticket sales plus allocated administrative expenses, the instant share of which is assumed to be 50%.

Exhibit 10

POWERBALL AVERAGE SALES PER DRAW
BASED UPON JACKPOT SIZE
BY FISCAL YEAR

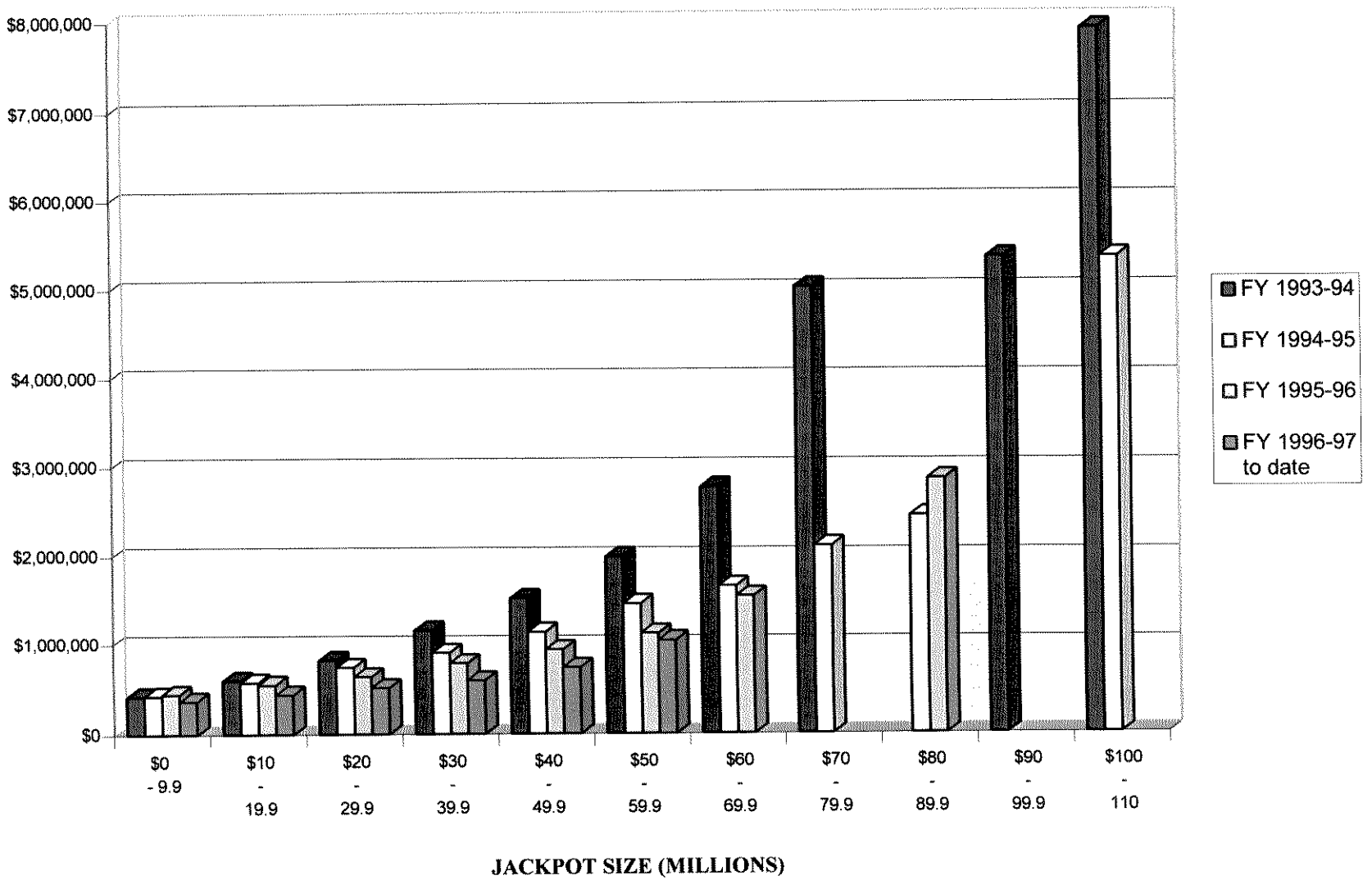
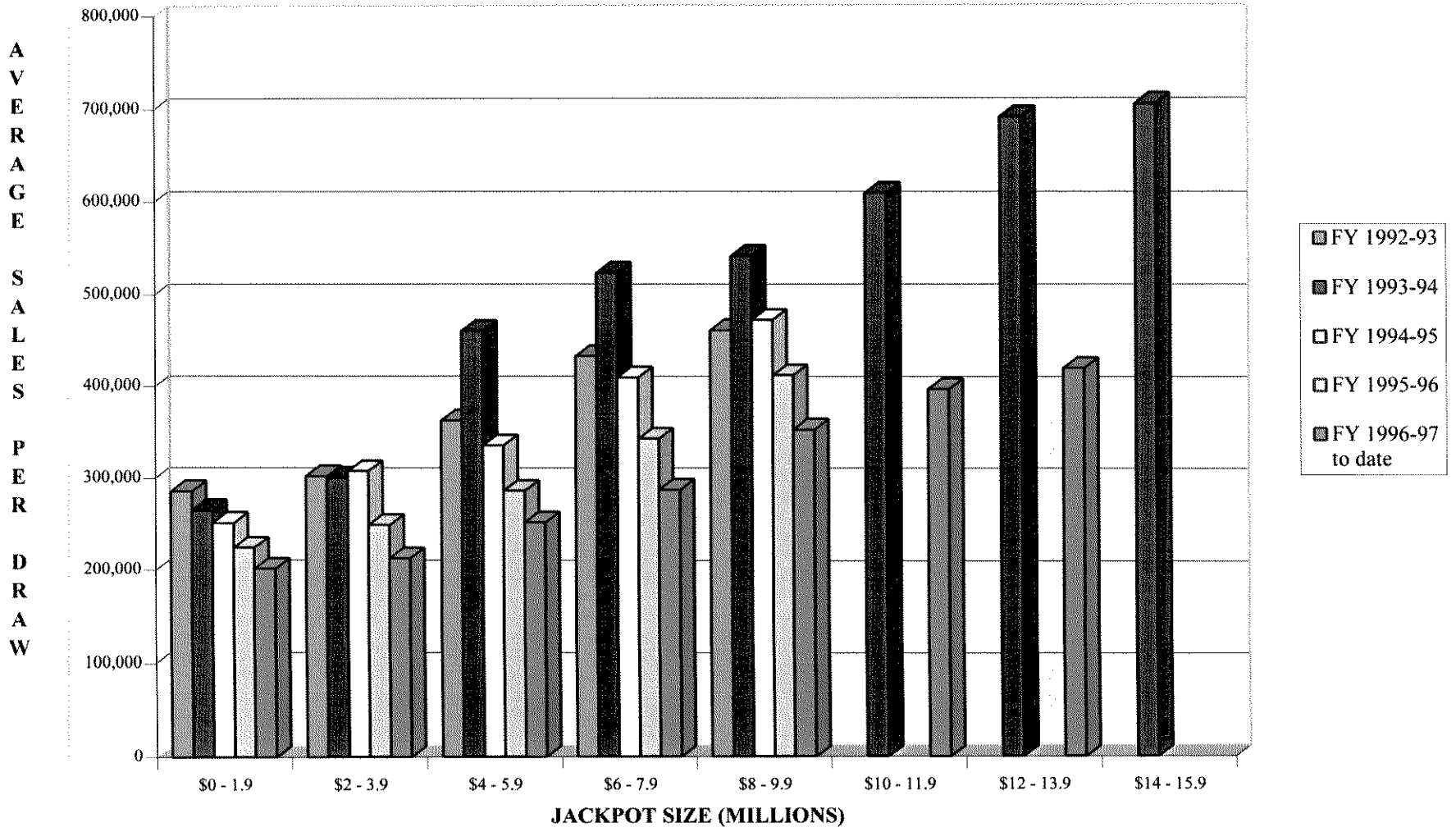


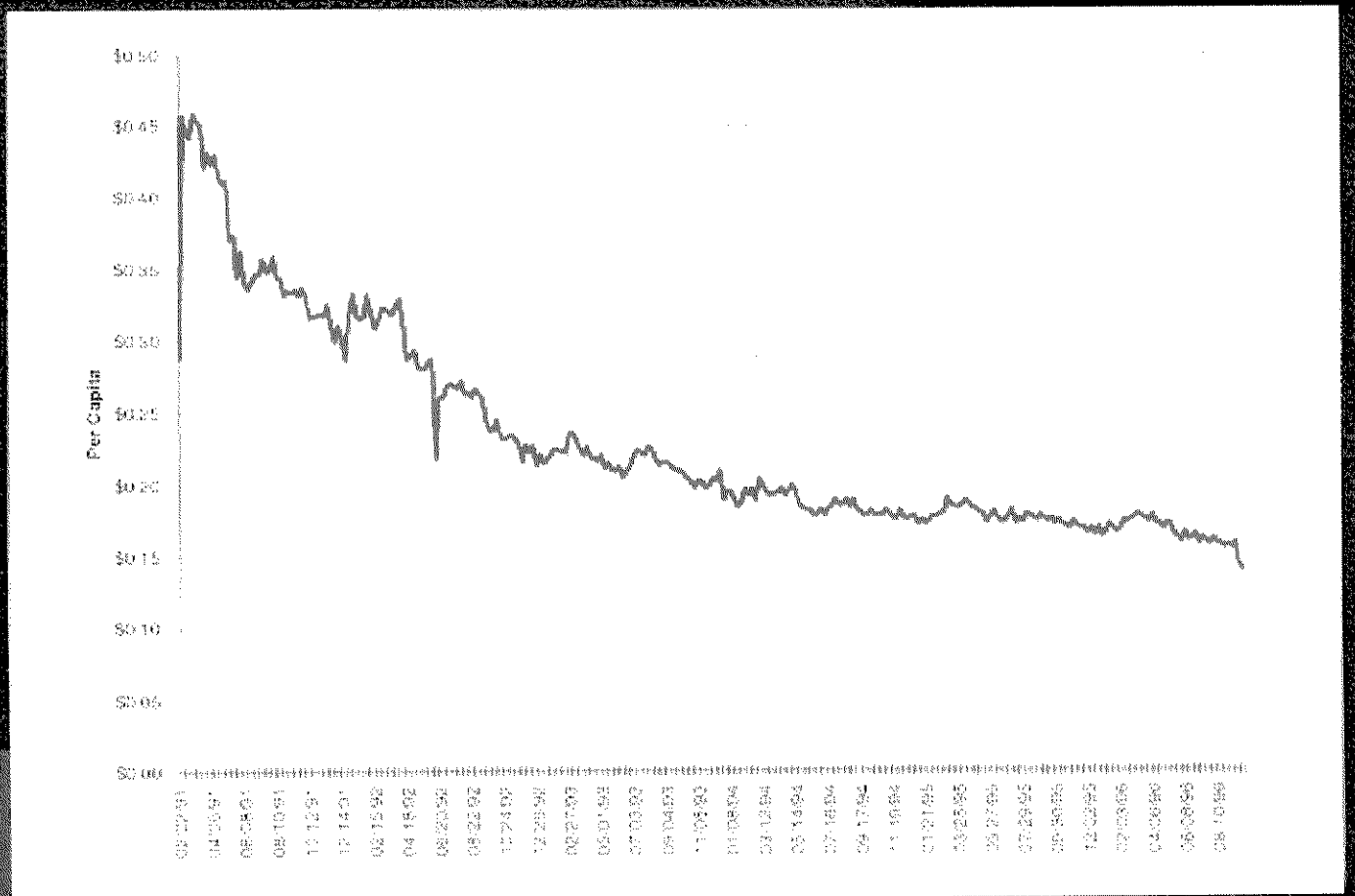
Exhibit 11

MEGABUCKS AVERAGE SALES PER DRAW
BASED UPON JACKPOT SIZE
BY FISCAL YEAR



GameScape™

SUPERCASH! Sales



Opinion

No Comparison

by Edward J. Stanek, Ph.D.
Iowa Lottery Commissioner

Americans seem to be fraught with the desire to compare anything and everything to see whose is bigger, stronger, cuter, richer, or whatever the case might be. Even though most lotteries know that comparisons between them are virtually impossible, journalists and politicos frequently make the attempt. There are so many differences among lotteries that the lottery playing field cannot be level enough to make effective comparisons, in particular regarding efficiency. Legal and budgetary constraints imposed by legislatures, along with differences in geography, demographics, history, culture and other factors make it impossible to compare one state lottery against another in any meaningful way.

For instance, some lotteries must pay for office space out of their operating budgets. Some lotteries are provided free space in a government office complex or were allowed to purchase office space at some point in their history so that rent does not appear as an ongoing expense. In fact, one eastern lottery not only resides rent free in a complex of state buildings, but also receives utilities at no cost from the heating and cooling systems shared by adjacent state properties.

The depth of background requirements to be provided by law enforcement varies from state to state. Some require the collection and review of tax returns and other in-depth financial data from a greater array of corporate officers and shareholders than is the case in other jurisdictions. In some cases, the background work must be done by law enforcement authorities with reimbursement from the lottery, while in other cases the law enforcement appropriation covers the bulk of the costs, which can range into the hundreds of thousands of dollars on an annual basis.

One lottery in the country is subjected to quarterly audits as opposed to semi-annual or annual scrutiny. The audit costs each year are in the six-figure range. Lotteries in states where the statutes require less forgo the extraordinary expense.

Some lotteries are quasi-governmental organizations which set the compensation structure for their own employees. But collective bargaining agreements in other jurisdictions may impose salary requirements for lottery employees with virtually no input from lottery management. The contracts are often negotiated by some centralized state personnel authority.

There may exist other anomalies in state laws which have different impacts. For example, in one state there is a requirement that a certain percentage of the vehicle fleet for all state agencies be composed of alternative fuel vehicles. The vehicles cost $1,100 more than ordinary autos or trucks, require a higher maintenance fee, and demand fuel which costs 54 cents per gallon more than gasoline. These expenses are not under the control of the lottery. No other lottery has comparable requirements and therefore no fair comparison can be made.

On-Line Costs

Two lotteries in the U.S. and all Canadian lotteries own their on-line systems. Other lotteries procure the use of equipment through competitive bids and pay for the cost of using that equipment on a royalty or lease-type of arrangement on an ongoing basis. Installment payments for some lotteries cannot be compared to the absence of installment payments for lotteries which purchase networks on a cash basis, especially since government accounting in general does not recognize depreciation.

Economies of Scale

Lotteries with large populations within their jurisdictions have the opportunity to negotiate significant cost economies because they are able to purchase scratch tickets in much larger quantities than can be purchased in smaller jurisdictions. Similarly, large jurisdictions can negotiate more economical on-line service contracts because of the sheer volume of transactions which are processed.

Opinion

Distribution Costs

Population density is important in determining lottery efficiencies. The delivery of scratch tickets and point of purchase materials in jurisdictions with high population densities is much more economical than is possible in states that are principally rural. One U.S. state has only 15 percent of its total population in its largest urban area, while others have as much as 80 percent of their population in a single metropolitan area.

Some lottery jurisdictions are small enough that a sales rep can drive the length or width of the state in less than an hour, while other states would require an overnight journey to accomplish the same. Establishing regional offices to service lottery clients is therefore necessary in some states, but not required in others.

Telephone Costs

Intrastate telephone rates may be unregulated in some jurisdictions. Lotteries are technologically intensive entities which increasingly depend upon linking electronic devices through telephone or radio mechanisms. Topography can limit the application of radio systems in some circumstances, while the lottery has no control over land-line rates. In particular, decentralized populations require the greater use of long distance communications and the greater use of local phone companies to provide access to long distance lines. One sparsely populated U.S. state contains 11 percent of all the independent telephone companies in the country. Its cost per terminal drop is the highest in the country and it has no alternative.

Urban Versus Rural Spending

Urban lottery customers tend to have higher per capita incomes and spend more money on recreation than do rural customers. In fact, there seems to be a significant correlation between per capita spending and the population density of an urban center. Environments conducive to lottery sales are not present in some jurisdictions.

Types of Games

The overhead associated with various games can be a factor in measuring lottery efficiencies and can be very misleading when expressed using percentages. Some games require higher pay-

Opinion

backs in order to maintain success and improve lottery bottom lines with volume. However, errors are made constantly by the media in trying to measure return to the state as though the lottery was either a tax or a charity where payments are not made back in order to maintain the viability of a product.

A recent Money magazine article erroneously tagged the Massachusetts Lottery as being one of the least efficient in the country because of its high prize payback percentages in instant ticket games. It is common knowledge within the industry that for the sale of instant tickets, Massachusetts ranks the highest in per capita sales and profits.

History and Culture

Three-digit daily games have been a mainstay of lottery sales in eastern metropolitan locations because the player-base was established generations ago with participation in numbers games administered by organized crime. After generations of exposure, these games became part of the culture and the business was transferable to legal lotteries once they were established. In general, little advertising support is required for maintenance of these games, but they have little following west of the Mississippi where numbers running did not play a historical role. This cultural difference can count for close to 50 percent of a lottery's total sales in an eastern jurisdiction while it accounts for virtually no market in the west.

Differences in Lottery Games

Games that are legal in some jurisdictions are not authorized by law in others. For example, video lottery games are high volume and very lucrative. In some cases, the money which is taken out of the machines is considered gross revenue and also gross profit. Such accounting systems can elevate a lottery's efficiency measurement astoundingly. Another lottery accounting system may measure the money put into the machines as gross sales, and thus its efficiency ranking would be skewed when compared to the former example. Still other jurisdictions do not have the legal latitude to offer video lottery games and therefore are penalized in comparative efficiency measurements.

Different Gaming Environments

In recent years, there has been a trend toward decentralizing the location of casinos. Indian trust lands, riverboats and pari-mutuel racing facilities outside of Atlantic City and Nevada have become sites for casino gaming. The increased availability of these entities in lottery states offers spending opportunities that directly compete with some lottery games. Is it fair to compare lottery sales in jurisdictions saturated with those entities as a measurement against the sale of lottery tickets where alternative gaming does not exist?

Population

Journalists are often apt to try to measure the playing field by measuring per capita this and that. The population measurements come from the Census Bureau and have a specific definition which may not conform to the availability of customers to purchase certain arrays of products. For example, the number of people who work in the District of Columbia in the daytime far exceeds the official nighttime residential population. Although the number of permanent residents in Florida may be a given quantity, the number of consumers in Florida varies sizably with the seasons. Residents of federal reservations and military bases may not be counted in a state population, and the number of illegal aliens may skew the consumer base in some states while being minuscule in others. Therefore, even per capita representations cannot be developed without bias.

Legal Age

In 1994, the Iowa legislature changed the legal gaming age to 21 years. With the stroke of a pen, 18-, 19- and 20-year-old Iowans lost the right to purchase lottery tickets and the Iowa Lottery lost five percent of its net profits while its expenses remained constant. Such legal changes can make lottery-to-lottery comparisons as unlevel as the Rocky Mountains.

Advertising

Some lotteries have restrictions on the amount of money that can be spent on advertising and others have restrictions on advertising content. There is no major soft drink company nor fast food chain that doesn't rely heavily on advertising to insure that customers routinely think about whether or not their products should be purchased. The amount required to meaningfully advertise depends on populations distribution, local rates and the availability of advertising media. Because of FCC regulations, some lottery states have found it impossible to broadcast messages to major segments of their populations because television and radio signals must originate across the border from a non-lottery jurisdiction. Most constraints placed on advertising for consumer products are national, and therefore uniform across the country. Lottery advertising is also regulated by legislative bodies in individual states. Such disparities further remove the possibility of objective comparisons of one lottery to another.

Apples to Oranges

Although systems may be conjured to attempt measuring the impact of certain constraints in one lottery jurisdiction relative to another lottery jurisdiction, the ability to do so is obfuscated by major disparities in other factors which constrain state lotteries in disparate ways. Tables ranking lottery efficiencies by profit as a percentage of sales or even operating costs as a percentage of either sales or profits can't fully recognize that the comparison is of apple to oranges. One lottery can't be measured with a meter stick while another is measured with a yardstick unless the conversion factor for centimeters to inches is known. Since there is no factor for converting one lottery environment to another, exercises in making state-by-state lottery comparisons are inherently flawed. ■