



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #696

Lottery Product Information Budget (DOR -- Lottery Administration)

Bill Agency

[LFB 2007-09 Budget Summary: Page 494, #2]

CURRENT LAW

The general program operations appropriation of the lottery is provided \$19,026,100 SEG in 2006-07. Of this amount, \$4,608,000 is allocated for the lottery's product information (advertising) budget. Constitutional and statutory provisions (discussed below) limit the manner in which lottery advertising is conducted.

GOVERNOR

Provide \$2,900,000 SEG annually for the lottery's general program operations to increase funding for advertising. Increase projected lottery sales revenue by \$15.0 million annually as a result of additional advertising of the state lottery.

DISCUSSION POINTS

1. The DOR budget request for the lottery did not include a request for additional funding for advertising. However, a proposal for the advertising increase was made under the Department's 10% budget reduction plan, which included proposed initiatives to generate additional revenue to the state. The plan projected additional lottery revenues of \$15.0 million SEG annually in the 2007-09 biennium by increasing the advertising budget by \$2,900,000 SEG annually.

2. The Governor is recommending the \$2.9 million in funding for advertising and includes the additional \$15.0 million in annual revenue in the lottery sales estimates under SB 40.

The \$2.9 million provided under the bill represents a 63% increase in advertising funding.

3. The Department arrived at the additional annual sales estimate of \$15.0 million after examining data from other states relating to advertising and reviewing other marketing work by independent research firms focusing on the lottery industry. According to Department officials, this research indicates that advertising generally provides a return of \$3 to \$18 for each dollar of advertising. An increase of \$15.0 million in sales based on a \$2.9 million increase in advertising reflects a gain of about \$5 in sales for each new advertising dollar spent. The \$15.0 million increase in sales under the bill would represent a 3.1% increase to projected 2006-07 sales (\$489.7 million). Lottery officials indicate that they tried to construct a conservative estimate. They cite, for example, a 2003 Pennsylvania study of advertising that concluded that a \$1 increase per adult in the state would produce about a 7% increase in lottery sales.

4. In light of this data, the Department's estimate of \$15.0 million in new sales may be reasonable. DOR has also developed fairly detailed plans for the use of the additional \$2.9 million in advertising funding provided under the bill. These plans reflect a strategy to boost both scratch ticket and on-line sales. Under the plan, \$1.35 million would be budgeted for instant game advertising and \$1.45 million for on-line game advertising. These amounts are further allocated to ad production and to the purchase of various types of media time. In addition, \$0.1 million would be budgeted for responsible gaming messages. Based on the Department's research, its experience with lottery advertising, and the planning done in preparation for the funding increase, lottery officials express confidence that the \$15.0 million annual sales increase can be achieved beginning in 2007-08.

5. A \$15.0 million increase in sales revenue, offset by the \$2.9 million in additional advertising expenditures, would produce a net gain of \$12.1 million. This gain would produce approximately \$3.6 million in additional funds for the lottery and gaming tax credit. This would result in about a \$2.50 increase in the annual, average lottery and gaming credit provided to primary homeowners. [The statewide average lottery and gaming credit for 2006(07) was approximately \$96.]

6. The \$4.6 million currently allocated for lottery advertising was established in 1990-91 and has remained unchanged since then. Funding increases for advertising were considered in biennial budget deliberations in 1993, 1995, and 1997, but, in each instance, the Legislature denied the increase.

7. Lottery officials indicate that the lack of any increases in lottery spending since 1990-91 has had the effect of reducing the capacity of the lottery to advertise because the purchasing power of \$4.6 million has declined over the years. Based on actual rates of inflation, the \$4.6 million provided in 1990-91 today has the purchasing power of approximately \$3.1 million. Viewed from another perspective, if lottery advertising funding had received annual increases since 1990-91 at the rate of inflation, the 2006-07 budget would total about \$6.9 million.

8. The premise underlying the recommendation to increase advertising spending is that

additional advertising will produce higher sales. This is a generally accepted marketing principle; however, it should be noted that there appears to be no clear correlation between advertising and lottery sales. For example, while the lottery's advertising spending has remained constant since 1990-91, lottery sales have varied substantially through this period, as shown in the following table:

**Lottery Sales
1990-91 to 2005-06**

<u>Fiscal Year</u>	<u>Sales</u>	<u>Percent Change to Prior Year</u>	<u>Fiscal Year</u>	<u>Sales</u>	<u>Percent Change to Prior Year</u>
1990-91	\$400,620,800		1998-99	\$428,196,100	2.3%
1991-92	445,842,100	11.3%	1999-00	406,670,200	-5.0
1992-93	495,131,900	11.1	2000-01	401,188,600	-1.3
1993-94	495,521,300	0.1	2001-02	427,550,300	6.6
1994-95	518,915,000	4.7	2002-03	435,037,800	1.8
1995-96	482,124,000	-7.1	2003-04	482,920,300	11.0
1996-97	431,091,100	-10.6	2004-05	451,872,000	-6.4
1997-98	418,640,300	-2.9	2005-06	<u>508,903,600</u>	12.6
			15-Year Change	\$108,282,800	27.0%

9. An analysis of national lottery data reveals further examples of the relationship between sales and advertising. The Attachment to this paper contains data on 41 lotteries operated in the United States (40 state lotteries and the District of Columbia). The data is for 2004-05 and includes: (a) total population; (b) total lottery sales; (c) per capita lottery sales; (d) advertising budgets; (e) per capita advertising spending; (f) advertising as a percent of sales; and (g) the sales generated for each \$1 of advertising.

10. Many anomalies are present in this data. For example, the two leading states in sales are New York (\$6,039 million in 2004-05) and Massachusetts (\$4,466 million). Massachusetts, however, had per capita sales (\$698), more than twice that of New York's (\$314). And yet, New York's advertising budget of \$72.8 million (\$3.78 per capita) was more than seven times the Massachusetts' budget of \$10.0 million (\$1.56 per capita). For each advertising dollar spent, Massachusetts produced \$447 in revenue, compared to New York's \$83. Wisconsin, spending only \$0.83 per capita for advertising produced \$98 in revenue in 2004-05 for each advertising dollar spent, outperforming New York in this respect.

11. Wisconsin's \$0.83 per capita advertising budget is the third lowest in the nation, with only Missouri (\$0.37 per capita) and North Dakota (\$0.33 per capita) being lower. And yet, Missouri takes in \$365 in revenue for each \$1 in advertising, third highest in the country. Wisconsin's \$98 in revenue for each advertising dollar spent ranks 14th by this measure. Of the 26 states and the District of Columbia ranking below Wisconsin in revenue generated per advertising dollar, all but one spend more per capita on advertising than does Wisconsin.

12. Sales per advertising dollar is a statistic developed for this paper and is not generally used in the lottery industry because it can disguise the operation of important factors affecting each lottery's sales. For example, sales are also affected by such factors as: (a) the effectiveness of advertising spending; (b) the media market peculiar to each state; (c) overall lottery management; (d) the culture in each state with respect to the gambling behavior of consumers; (e) the extent of tourist trade in each state; and (f) the degree to which competitive forms of gambling exist in or near a given state. This statistic and the examples cited above, however, help to illustrate that the amount spent on advertising does not have a clear relationship to sales.

13. Arguably, providing additional funding for advertising could be ineffective in certain contexts. If current advertising efforts are generally not productive, if the current media market for lottery advertising is saturated, or if lottery management is ineffective in its overall administration of a lottery, the provision of additional advertising funding could be questioned. Similarly, in a state where competing forms of gambling are lacking, advertising increases may not be justifiable. Each of these points, as they apply to the Wisconsin lottery, will be briefly addressed.

14. With respect to advertising effectiveness, the Wisconsin lottery appears to have performed reasonably well. Wisconsin's lottery advertising budget per capita ranks 39th and its sales per capita ranks 29th. As noted above, the Wisconsin lottery ranks 14th in sales revenue generated for each dollar of advertising. By these measures, the effectiveness of the advertising effort in Wisconsin may be viewed as relatively high.

15. Another factor is the principle that there is always a point where additional advertising will produce diminishing returns. In some markets, the level of advertising is high enough that any increase in advertising is likely to produce a smaller effect on sales. In other markets, a lower level of advertising may mean that an advertising increase could produce significant sales gains. Lottery officials argue that the latter is the case in Wisconsin because the advertising budget has been frozen since 1990-91, and its purchasing power has actually declined significantly since then.

16. In examining the management of the lottery, it must first be said that historically, specifically in the earlier years of lottery operations, significant lottery management issues emerged. These problems likely played a role in the Legislature's refusal to increase advertising funding for the lottery in biennial budget deliberations in 1993, 1995, and 1997. Two examples can be cited.

17. First, in the early 1990s, under the management of the original Lottery Board, questionable encumbrance practices were pursued that had the effect of increasing the amount of revenue available to the Lottery Board for expenditures in excess of those authorized in its budget. The situation was uncovered and DOA terminated the practice and made corrective adjustments to the expenditure authority of the lottery in March, 1993.

18. Second, in March, 1997, the Legislative Audit Bureau (LAB) reported on an evaluation of the state lottery. The LAB attributed the decline in sales over the prior two years primarily to the combined effect of an accelerated attempt to implement a privatization initiative

affecting certain lottery functions, while rapidly downsizing state lottery staff. The manner in which the changes took place caused: (a) lottery retailer services to deteriorate beginning in 1995-96; (b) an interruption in the introduction of new scratch ticket games in 1996-97; and (c) a significant increase in vacant lottery positions through the period (resulting in a vacancy rate of 63.5% in March, 1997).

19. These management problems played a role in the decision to transfer the state lottery to DOR, effective July 1, 1996, under 1995 Wisconsin Act 27. In general terms, it took the Department several years to stabilize lottery operations and to rebuild its capacity. Beginning in 2001-02 and continuing through 2005-06, sales have generally increased and have been reestablished at levels comparable to the early- to mid-1990s.

20. In examining LAB financial audits and program evaluations of the state lottery for recent years, no major management issues have been identified that would argue against the provision of additional resources for advertising.

21. When, in 1990-91, the lottery advertising budget was established at \$4.6 million, no state-tribal gaming compacts had yet been agreed to. Following the signing of the original compacts in 1992, tribal casino operations were quickly established and have grown consistently through the years. In 1992, net casino revenue (the revenue remaining after winnings are paid out) totaled about \$143 million. In 2005, net revenue increased to approximately \$1.1 billion. This development demonstrates the degree to which the competitive environment for gaming dollars has changed in Wisconsin since 1990-91. Arguably, the lottery's ability to compete in this environment has been hampered by the limitations imposed on its advertising budget.

22. To recap, the provision of additional advertising funding may not be advisable if current advertising efforts are generally not productive, if lottery management is ineffective, or where competing forms of gambling are lacking. It can be argued that these conditions do not currently apply to the Wisconsin Lottery. Given this context, the additional funding for advertising could be provided and the higher sales projected under the bill could result.

23. Alternatively, sales in recent years have rebounded from the decline experienced between 1995-96 and 2000-01 with no increase in the advertising budget. It could also be argued that no advertising increase be provided at this time because any sales increase is uncertain or could prove to be temporary in nature. In addition, if the current level of sales is considered adequate, the projected net sales gain of \$12.1 million and the associated \$2.50 increase in the average lottery and gaming credit could be viewed as too small to justify a budget change.

24. Another issue concerns the constraints on lottery advertising under current law. The Wisconsin Constitution allows the creation of a state lottery, the proceeds of which must be used for property tax relief. The Constitution also prohibits the expenditure of any public funds or lottery proceeds for promotional advertising of the lottery and stipulates that "any advertising of the state lottery shall indicate the odds of a specific ticket to be selected as the winning ticket for each prize amount offered." This language appears to allow the state to engage in informational advertising to

inform potential participants about lottery games, but precludes the state from conducting advertising that is promotional in nature.

25. Further, Wisconsin statutes define "promotional advertising" as advertising which is for the purpose of inducing persons to purchase lottery tickets. However, the statutes specify that promotional advertising does not mean advertising which is designed to provide the public with information on any of the following: (a) the fact that this state has a state lottery or participates in a multijurisdictional lottery; (b) the locations where lottery tickets or lottery shares are sold; (c) the price of lottery tickets or lottery shares; (d) the prizes or prize structure of the lottery; (e) the type of lottery game and an explanation of how it works; (f) the time, date and place of conducting the lottery; (g) the winning numbers, lottery tickets or lottery shares or the identity of winners and the amounts won; and (h) how the lottery is operated or how the net proceeds of the lottery are to be used.

26. To the extent that the Committee believes that the Governor's recommendation for increased lottery advertising funding would result in promotional advertising, increased funding may not be appropriate. As such, funding provided in the bill could be deleted. This alternative would also reduce estimated lottery revenue by \$15 million annually.

27. In addition to alternatives to either fund or reject the increase under the bill, an alternative could be considered that would provide additional advertising funds, but at a lower rate of increase. Under the bill, the \$2.9 million funding increase represents a 63% increase in the advertising budget. As noted above, if lottery advertising funding had received annual increases since 1990-91 at the rate of inflation, the 2006-07 budget would total about \$6.9 million. Extending this to the next biennium, inflationary increases would result in funding amounts of approximately \$7.1 million in 2007-08 and \$7.2 million in 2008-09.

28. Under the bill, total advertising funding would be increased to \$7,508,000 SEG annually in the 2007-09 biennium, exceeding the projected inflation-corrected amounts by \$408,000 in 2007-08 and \$308,000 in 2008-09. If the Committee wishes to bring the lottery budget in line with inflationary growth since 1990-91, it could modify the Governor's recommendation to instead provide an increase of \$2,492,000 in 2007-08 and \$2,592,000 in 2008-09. This would result in a total advertising budget of \$7,100,000 in 2007-08 and \$7,200,000 in 2008-09. The \$15.0 million projected sales increase under the bill would be adjusted proportionally to reflect this reduction to the bill (to \$14,180,000 in 2007-08 and \$14,380,000 in 2008-09).

29. Alternatively, a lower, but still significant, increase could be provided for advertising purposes. For example, if a 20% annual increase in funding (\$921,600 in 2007-08 and \$2,027,500 in 2008-09) were provided, the advertising budget for the lottery would be \$5,529,600 in 2007-08 and \$6,635,500 in 2008-09. Under this alternative, the \$15.0 million projected sales increase under the bill would be adjusted proportionally to reflect this reduction to the bill (to \$11,050,000 in 2007-08 and \$13,260,000 in 2008-09).

30. Under the alternatives to modify or delete the Governor's provision for additional

advertising funding, sales estimates would be adjusted. Similarly, sum sufficient appropriations for retailer compensation and lottery vendor fees would require modification to reflect the sales estimate changes.

ALTERNATIVES TO BILL

1. Approve the Governor's recommendation to provide \$2,900,000 SEG annually for the lottery's general program operations to increase funding for advertising. [Additional sales associated with the funding increase would total \$15,000,000 annually.]

ALT 1	Change to Bill		Change to Base	
	Revenue	Funding	Revenue	Funding
SEG	\$0	\$0	\$30,000,000	\$5,800,000

2. Modify the Governor's recommendation by deleting \$408,000 SEG in 2007-08 and \$308,000 SEG in 2008-09 for lottery advertising. This alternative would provide total additional funding of \$2,492,000 SEG in 2007-08 and \$2,592,000 SEG in 2008-09 for lottery advertising. Under this alternative, the sales estimate associated with the funding would be reduced by \$820,000 in 2007-08 and \$620,000 in 2008-09 to total \$14,180,000 in 2007-08 and \$14,380,000 in 2008-09. Modify the appropriation estimates for retailer compensation and vendor fees to reflect this sales estimate change to the bill.

ALT 2	Change to Bill		Change to Base	
	Revenue	Funding	Revenue	Funding
SEG	-\$1,440,000	-\$716,000	\$28,560,000	\$5,084,000

3. Modify the Governor's recommendation by deleting \$1,978,400 SEG in 2007-08 and \$872,500 SEG in 2008-09 for lottery advertising. This alternative would provide total additional funding of \$921,600 SEG in 2007-08 and \$2,027,500 SEG in 2008-09 for lottery advertising. Under this alternative, the sales estimate associated with the funding would be reduced by \$3,950,000 in 2007-08 and \$1,740,000 in 2008-09 to total \$11,050,000 in 2007-08 and \$13,260,000 in 2008-09. Modify the appropriation estimates for retailer compensation and vendor fees to reflect this sales estimate change to the bill.

ALT 3	Change to Bill		Change to Base	
	Revenue	Funding	Revenue	Funding
SEG	-\$5,690,000	-\$2,850,900	\$24,310,000	\$2,949,100

4. Delete provision. Lottery sales estimates under the bill would be reduced by \$15,000,000 annually. This alternative would maintain funding for lottery advertising at \$4,608,000 SEG annually. Modify the appropriation estimates for retailer compensation and vendor fees to reflect this sales estimate change to the bill.

ALT 4	Change to Bill		Change to Base	
	Revenue	Funding	Revenue	Funding
SEG	- \$30,000,000	- \$5,800,000	\$0	\$0

Prepared by: Art Zimmerman
Attachment

ATTACHMENT

2004-05 Lottery Sales and Advertising*

	State	2005 Population (in Millions)	Sales (in Millions)	Per Capita Sales	Advertising Budget (in Millions)	Per Capita Advertising	Advertising as % of Sales	Sales Per \$1 Advertising
1	Arizona	5.939	\$397.56	\$66.94	\$10.73	\$1.81	2.70%	\$37.04
2	California	36.132	3,333.62	92.26	33.97	0.94	1.02	98.15
3	Colorado	4.665	416.97	89.38	7.27	1.56	1.74	57.38
4	Connecticut	3.510	932.93	265.77	5.47	1.56	0.59	170.55
5	District of Columbia	0.844	234.93	278.51	5.12	6.07	2.18	45.88
6	Delaware	0.551	114.06	207.18	2.50	4.54	2.19	45.62
7	Florida	17.790	3,470.73	195.10	26.50	1.49	0.76	130.98
8	Georgia	9.073	2,734.35	301.39	19.50	2.15	0.71	140.22
9	Idaho	1.429	113.50	79.42	2.31	1.62	2.04	49.09
10	Illinois	12.763	1,814.35	142.15	Unreported	N.A.	N.A.	N.A.
11	Indiana	6.272	739.63	117.93	8.31	1.32	1.12	89.06
12	Iowa	2.941	210.67	71.63	5.91	2.01	2.81	35.64
13	Kansas	2.745	206.72	75.32	2.60	0.95	1.26	79.51
14	Kentucky	4.173	707.26	169.47	9.98	2.39	1.41	70.84
15	Louisiana	4.524	307.01	67.87	7.97	1.76	2.60	38.52
16	Maine	1.322	209.30	158.38	2.91	2.20	1.39	71.92
17	Maryland	5.600	1,485.73	265.29	13.65	2.44	0.92	108.84
18	Massachusetts	6.399	4,465.72	697.91	10.00	1.56	0.22	446.57
19	Michigan	10.121	2,069.48	204.48	18.62	1.84	0.90	111.13
20	Minnesota	5.133	408.00	79.49	6.30	1.23	1.54	64.76
21	Missouri	5.800	785.60	135.44	2.15	0.37	0.27	365.39
22	Montana	0.936	33.81	36.14	0.83	0.89	2.47	40.54
23	Nebraska	1.759	100.66	57.23	3.18	1.81	3.15	31.70
24	New Hampshire	1.310	227.98	174.04	2.50	1.91	1.10	91.19
25	New Jersey	8.718	2,274.36	260.88	14.96	1.72	0.66	152.03
26	New Mexico	1.928	139.24	72.21	2.58	1.34	1.85	53.97
27	New York	19.255	6,038.77	313.63	72.80	3.78	1.21	82.95
28	North Dakota	0.637	19.13	30.04	0.21	0.33	1.09	91.52
29	Ohio	11.464	2,159.13	188.34	19.50	1.70	0.90	110.72
30	Oregon	3.641	360.17	98.92	6.67	1.83	1.85	54.02
31	Pennsylvania	12.430	2,644.86	212.79	30.00	2.41	1.13	88.16
32	Rhode Island	1.076	241.88	224.76	2.00	1.86	0.83	120.94
33	South Carolina	4.255	956.95	224.90	7.71	1.81	0.81	124.12
34	South Dakota	0.776	32.50	41.89	0.81	1.04	2.49	40.22
35	Tennessee	5.963	783.70	131.43	13.83	2.32	1.76	56.67
36	Texas	22.860	3,662.46	160.21	33.00	1.44	0.90	110.98
37	Vermont	0.623	92.59	148.61	1.23	1.97	1.33	75.40
38	Virginia	7.567	1,333.95	176.27	13.61	1.80	1.02	97.98
39	Washington	6.288	458.13	72.86	6.26	1.00	1.37	73.18
40	West Virginia	1.817	194.19	106.88	6.20	3.41	3.19	31.32
41	Wisconsin	<u>5.536</u>	<u>451.87</u>	<u>81.62</u>	<u>4.60</u>	<u>0.83</u>	<u>1.02</u>	<u>98.23</u>
	Total	266.560	\$47,364.44	\$177.69	\$444.24	\$1.67	0.94%	\$102.53

*Based on sales and advertising budget data reported in *La Fleur's World Lottery Almanac -- 2006*.