



M E M O R A N D U M

Date: June 26, 2009

To: California State Lottery Commission

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Director

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Subject: Item 9(b) – Business Planning Consultant

ISSUE

Should the California State Lottery Commission (Commission) approve a consulting contract with Camelot Global Services Limited (Camelot) for assistance in developing and implementing the California Lottery's business plan?

RECOMMENDATION

California State Lottery (Lottery) staff recommends that the Commission approve a consulting contract with Camelot Global Services Limited for assistance in developing and implementing the Lottery's business plan. Staff believes that this contract will implement fundamental improvements to Lottery operations, help transform the Lottery into a more efficient and effective organization, and significantly improve the Lottery's performance.

BACKGROUND

In 2007, the Commission approved a long term business plan that was designed to set the Lottery on a course of change and operational improvement. This resulted in the current 2007-2010 Business Plan. This plan focused on the need for long term planning, improving our brand image, deemphasizing jackpots, and modernizing our operations.

The Lottery accomplished many initiatives, pushed the boundaries of the lottery industry, and tested sacred cows. The Lottery was successful in educating key stakeholder groups and laying a foundation for change. We began improving our brand image with a new marketing strategy and logo that culminated in the successful launch of the Lottery's new game show, *Make Me A Millionaire*. These efforts have increased sales of *Make Me A Millionaire* tickets 40% over the *Big Spin* tickets and have lifted

sales of the entire Scratchers product line. This plan also opened the door to creative thinking and testing new games and promotions. Prior to this plan, the Lottery had not introduced a new game in seven years, with the exception of MEGA Millions. New draw games included the Raffle and Daily 4. Innovative promotions included the Breeder's Cup and Mad Money. We also showed that proper messaging and marketing could motivate players to play at lower jackpot levels with the "Only" campaign. We also began a series of efforts to evaluate and plan for changes to our outdated back office systems and processes. We deployed thousands of electronic point of sale devices and began a successful consumer protection program.

The 2007-2010 Business Plan was a good start, but it has run its course and development of the next business plan is imperative to continuing our positive momentum and maximizing profits for education.

DISCUSSION

Engaging Camelot to help develop the next business plan and assist with implementation will help the Lottery realize its full potential. Over the last three years, the Lottery has engaged in a series of discussions with several entities for assistance with business planning, but none have been able to provide a comprehensive set of services or resources that meet our needs or goals. Other vendors could provide pieces of the puzzle, but not the whole picture. More importantly, other vendors did not possess the ability to see and help manage the many complex interdependencies or the ability to stay on to implement, train, and share knowledge. Alternatively, the Lottery could attempt to develop and implement initiatives on its own, as it has tried in the past, but it would take much longer, involve much trial and error, ultimately cost more, and we would be less confident in the results.

With Camelot's assistance, the Lottery will be able to set a course toward sustainable growth and improved performance now and into the future that will help it meet its mandate to education. Camelot has been where we are today. They have the experience, learned through trial and error, understand the lottery business, currently operate a lottery, and have developed and implemented successful business tools and methodologies.

This contract will create a partnership between the Lottery and Camelot where Camelot will work side-by-side with our staff to implement a business plan that is developed using Camelot's tools, but tailored to California's unique needs and environment using our internal expertise. We are not simply overlaying the United Kingdom's lottery model over California. We are utilizing Camelot's tools and experts to jointly develop strategies and initiatives that are specifically tailored to California's unique and diverse marketplace.

Camelot will aid the Lottery in evaluating the following areas: retailer and sales support services; advertising, promotions, and player communications; products, price, and

portfolio; Scratchers distribution and accounting; corporate social responsibility, and stakeholder management. The deliverables and services are broken down as follows.

- Business plan development deliverables
 - Business plan
 - Lottery business data (current performance, organization, historical performance, comparison against other lotteries)
 - Marketing/Game plan (prize payout, games types, pricing, launch/enhancement schedule, marketing communications strategies)
 - Retail channel plan (approach to retailer services and support)
 - Operational plan (key processes, process improvement schedule, key cost and efficiency analysis)
 - Summary financial plan (current performance, sales plan, capital plan, three year profit & loss forecast)
 - Risk and sensitivity analysis (risk mitigation plan, sensitivity of the profit & loss forecast under different scenarios)
 - Scratchers distribution, accounting and development process optimization
 - Financial model
 - Corporate social responsibility
 - Implementation roadmap
- Program management
 - Camelot will provide experienced project managers to work on overall management of the program
- Implementation support
 - Camelot will provide subject matter experts to assist the Lottery with implementation of the initiatives throughout the engagement to help assure successful execution
- Executive strategy sessions
 - Throughout the course of the engagement, Camelot will host executive strategy sessions where they will provide subject matter experts and Camelot executive team members to continually evaluate the project and learn from each other

The offering by Camelot is comprehensive and well thought out. This engagement differs from typical consultant arrangements because Camelot has the ability to offer implementation assistants and subject matter experts with current, real world experience. In addition, a tremendous long term benefit to the Lottery is Camelot's commitment to mentoring, knowledge transfer, and training. The lasting, fundamental change that will be implemented will allow the Lottery to reap the benefits of this engagement long after the contract term ends.

The Lottery has negotiated the following payment terms with Camelot. Camelot will receive an all inclusive flat fee of up to \$3.5 million for these services and will be paid upon the Lottery's approval and acceptance of specified deliverables throughout the

course of the contract. For items with no specific deliverables, Camelot will be paid based on the days actually expended. If Camelot expends fewer days than anticipated, their payment will be proportionately reduced. If the Lottery were to contract for a typical consultant arrangement, staff estimates that it would cost between \$5 and \$6 million.

In addition to the flat fee, the contract is structured such that Camelot will receive a performance fee only if it is able to help the Lottery increase profits to education. This is different than other Lottery contracts that are based on a percent of sales. Basing the performance fee on incremental profits aligns our interests with Camelot's. Specifically, Camelot will receive a fee equal to 5% of any incremental net profits above fiscal year 2008/2009 levels. Camelot is only eligible to receive a performance fee in fiscal years 2010/2011, 2011/2012, 2012/2013. If the Lottery receives prize payout flexibility, the rate drops from 5% to 2% to represent the portion of increased profit that can be attributed to Camelot's assistance. In addition, performance fees are capped at \$5 million per year for fiscal years 2010/2011 and 2011/2012; and \$10 million for fiscal year 2012/2013. There is also an overall cap of \$10 million such that Camelot can never earn more than \$10 million in performance fees. Performance fees are paid out of the administrative budget. This performance fee represents a tremendous return on investment for the Lottery. For example, if Camelot earns \$10 million in performance fees, education would receive \$200 million in additional funding.

Finally, the Lottery has negotiated a refund with Camelot where the Lottery may receive a refund of up to \$1 million. If Camelot earns \$5 million in performance fees, the Lottery will receive a \$500,000 refund. If Camelot earns \$10 million in performance fees, the Lottery will receive an additional \$500,000 refund. This model is intended to compensate the Lottery for helping Camelot develop consulting tools and lessons learned that it would use in future engagements with other entities.

This contract contains clauses for termination without cause where performance fees would be reduced on a pro rata basis. The Lottery may also reduce the number of consultant staff days at the Lottery's sole discretion. Staff is requesting a total expenditure authority of \$13.5 million to cover the four-year contract period from July 2009 through July 2013.

If approved, work will begin in July 2009 and will continue through July 2011. Implementation of certain agreed upon "quick-win" projects will begin simultaneously with development of the business plan. The Lottery expects to see results as individual components are completed. This means we will not begin to see an impact on sales until after 8-10 months and steadily building thereafter. Staff believes that these terms represent a very good investment and that implementation of this plan will result in significant profit growth for education.