

Transformation of the D.C. Lottery: A Case Study

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Executive Summary

I. Introduction

Organizational change or transformation management projects occur repeatedly in Corporate America. Frequently, these transformation projects are required by market conditions and are inspired by visionary leadership in response to an external stimulus occasioned by declining stock prices, customer dissatisfaction, rapid changes in technology, or a major shift in the regulatory environment. The latter is often inspired by a renewed focus or legislative mandate to achieve financial certainty and transparency, as well as to supplement market sustainability (e.g., Sarbanes-Oxley).

The imperatives for transformation in the state and local government setting are less exact. Usually they require a politically motivated regime change or a dramatic service delivery failure (i.e. Hurricane Katrina, 9-11) before change, innovation, and the tenets of continuous improvement are discussed or applied to state and local government agency operations. As a result, major transformation projects rarely occur in the public sector. However, recently one such transformation project was launched by the District of Columbia's Office of the Chief Financial Officer to transform the operations of the District of Columbia Lottery and Charitable Games Control Board ("**DCLB**"). The expected transformation of the agency offers a rare glimpse into the potential effectiveness of applying the levers of traditional transformation concepts to the public sector.

As a result, I propose to develop a presentation for your conference and/or a full case study based on the information contained in this brief abstract. The presentation would be more geared to recent transformational successes, the agency scorecard project, and recent financial results. A case study would be more structured toward the overlay of transformational actions and outcomes. I have given similar presentations to lottery specific groups and they have been well received. I believe that the topic is both timely and relevant to your audience as well.

A. *Background*

The DCLB has been in existence for over 22 years and is considered a mature lottery in the industry on the basis of its years of service, product set, and technical operation. In fiscal year 2004, DCLB generated over \$240 million in revenue and transferred over \$73 million to the District of Columbia. Since its inception, DCLB has generated \$3.8 billion in gross revenues and has transferred over \$1.2 billion to the District's general operating fund. The capital in the general fund is used for a variety of District expenditures including school, fire, safety, and transportation expenses. Over the past ten years DCLB has been a successful operation, however its compound average rate of growth for top line revenue and its corresponding transfer growth rate has remained relatively constant in the 1% range, while other similarly situated lottery organizations have been able to grow at three times that rate. In more populous jurisdictions, like New York State, the lottery there now generates over \$5 billion annually. As an industry domestic lotteries now generate over \$50 billion per annum. Despite having one of the highest per capita rates for its core numbers games (pick three, pick four, etc.) and for its lotto style games (PowerBall), as well as attractive growth rates for its instant ticket products, DCLB has not been able to rapidly accelerate its growth rates, real dollar volume, or to dramatically increase its contribution of operating profits to the District.

B. Industry Perspective

The industry as a whole is facing similar problems as the product life cycle of core lottery products has moved into the mature stage, the number of state lotteries has increased, and the core player base has either declined, or has failed to capture the imagination of the 21-35 year old demographic. Faced with these trends and an ever-growing need for revenue dollar support, states have started adopting more aggressive forms of gaming styles featuring rapid draw games like Keno and pushing into the slot machine frontier. The states that have adopted these measures (e.g. Massachusetts, Delaware, West Virginia, etc.) have been able to energize their lotteries and rapidly improve their revenue acquisition. States that have taken a more conservative approach to the lottery business have been left to managing the lottery business from the expense side and have recently been cutting costs, headcount, and operating expenses like advertising (e.g., Minnesota, Colorado, Texas). They have also been looking for other ways to energize their operations through the hiring of professional management, outsourcing, and auditing the procurement relationships between vendors and state employees. The latter phenomenon is of a more recent vintage and the results have yet to be reported.

II. Analysis

Faced with the operating realities facing at least 49 other state lotteries, and some 26 lotteries that comprise the Multi-State Lottery ("MUSL") organization, DCLB was required by the Chief Financial Officer for the District, Dr. Natwar Gandhi, to seek out

new ways to increase performance, professionalism, service delivery, innovation, and profits back to the District of Columbia. The reasons for this include a drastic need for additional funds for schools and social services, competitive limits on the ability to raise or alter the real property and sales tax landscapes, and an inherent, but unsubstantiated belief that DCLB was not being operated efficiently. Simply stated the operating imperative is to produce significantly more, utilizing significantly less personnel and resources.

A. *Architecting the Transformation*

In order to accomplish the same, DCLB hired a new Chief Operating Officer and tasked him with the requirements to improve the organization through institution of a top to bottom transformation management process, featuring performance measurement management, developing an operating scorecard, establishing operating metrics, and redesigning the organization from top to bottom. Prior to instituting this program, DCLB had approximately 110 employees in its operation, and at least 60% of the workforce had been with the lottery for over 15 years of service. Many of these employees were maxed out at the top grade levels for their positions, had not received formal training in a number of technical areas, and operational effectiveness and efficiency were not being mandated or measured.

In order to systematically attack these problems on several fronts, DCLB's COO helped to institute a four-part program aimed at turning around the operation of the agency. Specifically, shortly after his arrival the agency commenced development of a short term and medium range strategic plan that focused on reaching new customers; gaining control of employee performance; helped to identify key markets and constituents; as well as changed the focus of the organization to be centered on dramatically increasing bottom line support to the operations of the District. The strategic planning process was developed, initiated, and implemented within 90 days of conceptualization.

B. *Strategic Transformation Steps*

Almost immediately after the completion of the strategic planning process, the COO launched into development of an assessment and benchmarking study for the agency. The assessment was designed to do a complete evaluation of the skills, abilities, and competencies of the employees of the organization; to measure throughputs and outputs of the executive office and staff; as well as to optimize the structure and functioning of the organization. It featured one-on-one interviews, group meetings, a paper process analysis, and a relationship to the agency strategic plan. The benchmarking activity was designed to buttress the assessment analysis by looking at four similarly situated lottery organizations around the country and evaluating "better practices". This activity was contemplated, initiated, and executed within 5 months of final approval. The report generated from this activity, among other things, advocated significant re-engineering of

agency operations, changing the alignment of critical functions within the organization, upgrading staff capabilities, and enforcing a more thorough performance evaluation of the managers and the staff.

C. Early Stages of the Transformation

Upon receipt of the report and management plan, the Chief Financial Officer adopted an aggressive position on reorganizing the agency and called for the abolishment of all employee positions at DCLB and a complete restructuring of the agency. In the process, the agency's operating budget was slashed by 20% (\$2 million) and agency headcount was reduced to 79 full time equivalents. Within the new reporting structure a number of new positions have been created with a focus on technology, sales, marketing, and the financial operation. Also, core back office functions like Human Resources, Procurement, and Legal were outsourced to a central government office.

Over a 10-day enrollment period, DCLB received over 700 applications for its 79 positions. In this phase the DCLB COO created unique, fact based hypothetical questions to be applied to each job opening, and an independent panel was convened to conduct all agency interviews. Within 5 months of initiating interviews, the COO scripted project had resulted in 70 positions being filled. The process resulted in over 45% infusion of new employee talent, which on paper included a significant upgrade in the business experience and academic achievement of the workforce.

That talent infusion has already had a significant impact on the functioning of the agency. In less than a year, DCLB has planned or launched 2 new lottery games, and revised one of the major games in its portfolio (Powerball). This level of new product support matches the number of new product introductions that had been brought to the market by DCLB over the previous decade. In addition, the organization instituted an outsourcing arrangement with its instant ticket vendor that will generate at least \$500,000 in cost savings during its first year in operation and has the potential to grow revenues by \$5-\$7 million within 18 months. For these as well as other innovations DCLB was awarded a number of recognition awards by the National Association of State and Provincial Lotteries at its 2005 Annual Meeting. The COO in particular was awarded the prestigious Powers Award for innovative lottery operations and pioneering operational improvement. Also, despite the energy and effort dedicated to the restructuring, a major change in processing, and a near historic drop in the key performance of several major product lines, DCLB was able to produce results nearly identical to the previous fiscal year. In addition, the strategic planning process, altering of the technology capability of the organization, and significantly improved market research suggests that next fiscal year will be a monumental year.

III. Market Implications

The restructuring activity at DCLB is garnering a lot of attention around the industry. DCLB is at the forefront of the creative destruction process, massive implementation of transformation, and government re-engineering in a unique segment. At least 49 other states have an interest in the actions taken thus far, and are awaiting an indication from the market that the process undertaken will produce substantially better results. Potential interested parties also include elected officials, lottery vendors, and recipients of public funding. Others should include think tanks, opinion makers, and lottery industry thought leaders. As a result, significant structural analysis in this market segment could have far reaching implications for several disciplines including public finance, business process re-engineering, technology, change management, organizational behavior and development, job training, and the social implications of public support for gambling. To my knowledge the entire area has yet to attract an academic following or research support from foundations and funding institutions. There have been no business cases chronicling the forces and factors affecting the lottery industry, and given the nature of state fiscal affairs, the issues are timely and could generate significant market value.

IV. Conclusion

The lottery industry is going through major changes associated with its product life cycle, product positioning, competitive forces, and the demands by the public for greater revenue support. These factors have far reaching implications on a number of institutions and government operations around the country. The District of Columbia Lottery is currently heavily engaged in the change management and creative destruction process in the effort to revamp its operations and produce substantial improvement in its financial results. Industry observers around the country are watching the issues addressed here. There is potentially a large, untapped market for research, focus, and discussion in this very important market segment.

Please reply to:

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