



National Lottery  
Commission

# Statement of Reasons

Licence to run the National Lottery

7 August 2007



## Summary

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The National Lottery Commission has selected Camelot Group plc as Preferred Bidder<sup>i</sup> for the next ten-year licence to run the National Lottery<sup>ii</sup>. The Commission will now seek to finalise with Camelot Group plc the details necessary to enable it to award the Licence<sup>iii</sup>. The Invitation to Apply provided that a Reserve Bidder may also be appointed and the Commission has selected Sugal & Damani UK Ltd as Reserve Bidder<sup>iv</sup>.

The National Lottery Commission (“the Commission”) invited Bids on the basis of its Invitation to Apply (“ITA”) and has rigorously evaluated them in accordance with the process set out therein. There were two parts to the evaluation. The first part was Required Standards, which each Bid was required to meet. The second part was returns to good causes, which were then the basis of comparison between Bids<sup>v</sup>.

The Commission has concluded that both Camelot Group plc (“Camelot”) and Sugal & Damani UK Ltd (“SDUK”) met each of the Required Standards set out in the ITA. Therefore, both Bids were judged to be capable, among other things, of providing the modern, flexible technology required to run the National Lottery, delivering transition<sup>vi</sup> successfully and ensuring high standards of propriety and player protection. The Commission was then able to assess both Bidders on their likely returns to good causes.

In reaching its decision, the Commission has drawn on its analysis of Bidders’ responses to all areas of returns to good causes. It has concluded that Camelot’s Bid is better able to maximise returns to good causes. Based on an analysis of each business plan, at similar levels of likely sales, Camelot is slightly more generous to good causes than SDUK. More significantly, the Commission concluded that there was a strong probability that Camelot would achieve higher sales than SDUK, once the relative strengths and weaknesses of the evidence provided by the Bidders in support of their sales forecasts had been taken into account.

The remainder of this statement sets out more fully the background to the competition and the assessment of the main factors the Commission has weighed in reaching its decision that Camelot’s Bid is better able to maximise returns to good causes. Accordingly, Camelot is selected as Preferred Bidder.

## Background

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The Commission is the regulator of the National Lottery. In exercising its functions, it has three overriding statutory duties:

- To secure that the National Lottery is run, and every lottery that forms part of it is promoted, with all due propriety;
- To secure that the interests of every participant in the Lottery are protected; and
- Subject to these, to do its best in exercising its functions to secure that the net proceeds of the National Lottery are as great as possible.

The Commission issued an ITA and Draft Licence in June 2006, following a period of nearly two years' consultation and engagement with a range of stakeholders on the shape of the competition. Further detail on the competition process can be found in the summary document *Background: Licence to run the National Lottery* published by the Commission<sup>vii</sup>.

The ITA identified that the Commission was seeking a Licensee to provide a complete solution for the Lottery, including: setting up and running the Lottery; designing, building, financing and operating the requisite infrastructure and systems; designing, distributing and marketing Lottery games; and ensuring a smooth transition of the Lottery from the current operations.

On 9 February 2007, the Commission received Bids from Camelot and SDUK. Each Bidder had to satisfy the Commission of its ability to deliver the proposed solution in time for the start of the Licence on 1 February 2009, and to operate throughout the Licence Period in accordance with the Licence and the regulatory environment and in a manner that enables the Commission to comply with its statutory duties.

A robust and detailed analysis of both Bids was carried out in accordance with the process set out in the ITA. This included: seeking further information from Bidders; allowing them to address deficiencies identified; holding bidder presentations; and conducting site visits<sup>viii</sup>. There were two parts to the evaluation of Bids:

- Required Standards - the Commission needed to be satisfied that the Bid met these Required Standards; otherwise the relevant Bidder would not be eligible for the award of the Licence.
- Returns to good causes – the Commission would select the Bidder that met all of the Required Standards and that, in its opinion, offered the most economically advantageous Bid that is best able to maximise returns to good causes based on an analysis of the deliverability of its business plan.

## Required Standards

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For each of the seven demanding Required Standards, the ITA set out the requirement, the evaluation criteria and the evidence required from the Bidder. The Commission assessed Camelot's and SDUK's ability to meet a Required Standard separately from the subsequent evaluation of returns to good causes. Required Standards were not used as differentiators between Camelot and SDUK. The Required Standards are set out below:

- **Propriety:** The Commission must be satisfied that the Lottery will be run with all due propriety. It must be satisfied that those likely to manage the business, or for whose benefit the business is likely to be conducted, are fit and proper;
- **Player protection:** The Commission must be satisfied that the Bidder has made the necessary arrangements to ensure that the interests of every participant in the Lottery will be protected, that players are treated fairly, and that effective and rigorous arrangements are in place to counter excessive and underage play;
- **Transition:** Each Bidder must satisfy the Commission that the Bidder is able to deliver transition successfully. Each Bidder must have a comprehensive transition plan that is fully supported by the appropriate skills, resources and capability of that Bidder and its Consortium. Each Bidder must also fully satisfy the Commission that the Bidder is able to identify, monitor and manage any associated significant transition risks and take appropriate action to mitigate those risks;
- **Organisation:** Each Bidder must satisfy the Commission that it has the capacity and ability to plan, organise and operate an undertaking of the nature of the Lottery. It must also satisfy the Commission that it has, or will have, the appropriate corporate or legal structures in place to comply with the requirements set out in the ITA;
- **Financial soundness:** Each Bidder must satisfy the Commission that its proposals are sufficiently robust and well-developed to remove any material risk, on financial grounds, that may lead to a failure to meet the obligations set out in the Bidder's proposal and the Draft Licence;
- **Technology operation:** Each Bidder must satisfy the Commission that it will ensure the security, capacity, resilience and integrity of the technology operation, as well as its suitability as a basis for a modern lottery. The Commission must be satisfied that the technology operation will be developed, operated and maintained to appropriately high professional standards; and

## Required Standards

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- **Operational risk management:** Each Bidder must have a comprehensive risk assessment and risk management plan that fully satisfied the Commission of its ability to identify and assess significant operating risks; put in place sufficient measures to address those risks; and monitor such risks in a way that effectively supports the delivery of the Bidder's objectives.

The Commission concluded that both Camelot and SDUK met each of the Required Standards. This assured the Commission that, whichever Bidder were granted the Licence, the National Lottery would be run with all due propriety and protect the interests of every participant in line with the Commission's overriding statutory duties. That both Bidders had met the Required Standards also provided the Commission with assurance that the Bids do not present a material risk on financial grounds, that Bidders have the capacity to operate an undertaking of the nature of the National Lottery and that Bidders would provide modern, flexible technology suitable for a modern lottery. On transition, both Bidders satisfied the Commission that they have comprehensive transition plans and both have the ability to effect transition successfully, identifying the associated risks and mitigating them appropriately.

## Returns to good causes

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Once the Commission was satisfied that each Bidder had met each of the Required Standards, it considered which Bid is better able to maximise returns to good causes. Returns to good causes, or contributions, are ultimately determined as a result of two elements: the proportion of any revenues that is available for good causes after deducting prizes, Lottery Duty, retailer commissions and retentions to cover the Bidder's own costs and generate the required return; and the ability of the Licensee to generate sales.

This part of the evaluation comprised a combination of comparative and absolute assessments of the Bids through a detailed analysis of Bidders' business plans, contributions to good causes and marketing plans. The Commission's task was to identify which Bidder was most likely to maximise returns to good causes, rather than to determine the sums each Bid was likely to deliver. It is on the basis of this assessment that the Commission has decided which Bidder is the Preferred Bidder.

In order to make an informed assessment, the Commission considered the evidence provided by the Bidders to enable it to understand the key drivers of these contributions, including information on business plans, contributions to good causes, marketing plans, game plans, player access plans, marketing and communications plans and marketing resource and sales plans.

The Commission tested the relative strengths and weaknesses between each Bidder. Each of Camelot's and SDUK's financial projections was separately adjusted to take into account the Commission's assessment of its deliverability based on its robustness and the associated risks. Contributions were calculated for a range of sales projections and other sensitivity tests, and the expected present values of contributions calculated for each Bidder based on an assessment of the likely probabilities of different scenarios occurring.

### **(i) Business plan**

Each Bidder was required to submit a detailed business plan in support of its Bid. They were required to submit a number of versions of their plans, including: a version based on the Bidder's forecast revenues (Principal Forecast); a version based on the Common Sales Scenario<sup>ix</sup> and versions based on specified sensitivity tests.

The evaluation of business plans comprised a combination of comparative and absolute assessments. The main purpose of this part of the Commission's analysis was to understand the key factors of each Bid which influenced the contribution offered by that Bid, and to assure the Commission that the Bidder remained viable at a range of sales levels. The Bidders' Principal Forecasts<sup>x</sup> contain undiscounted forecast sales over the ten-year licence period of £79.0 billion (£22.0 billion returns to good causes) in the case of Camelot and £63.9 billion (£17.9 billion) in the case of SDUK<sup>xi</sup>. By comparison, actual sales so far have varied

## Returns to good causes

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between £4.6 and £5.0 billion a year over the second licence period. Most importantly, the Commission did not accept these figures at face value, since its task was to consider critically the achievability of these Principal Forecasts as part of its assessment of marketing sales plans (see section ii below and the first paragraph of section iii).

### ***(ii) Contributions to good causes***

This element focused on the retention structure that will be applied to revenues in order to determine what proportion of revenues each Bidder proposes to retain, but also how the proposed retention structure affects incentives of each Bidder to generate those revenues. The overall incentive structure is intended to relate each Bidder's profits as closely as possible with its contributions to good causes.

The Commission also analysed how the proposed retention structure affects the incentives of each Bidder to generate revenues across different games types and distribution channels. The Commission's analysis suggests that, for Camelot, the retention structure adopted provides generally positive incentives. The Commission notes, however, that there appear to be slight disincentives at low revenue levels for a limited number of games. However, the Commission recognised that Camelot's management incentives were aligned to achieving the levels of sales set out in its Principal Forecast. For SDUK, the retention structure adopted also provides broadly positive incentives. However, there appear to be disincentives across a range of outcomes in relation to certain games sold through retail channels. This was factored into the overall analysis.

At sales levels around those set out in the Common Sales Scenario, the commitments offered by Camelot would lead to slightly larger contributions to good causes than would SDUK – the rate of return to good causes being higher by between 0.3 and 0.5 percentage points. The differences between the respective rates of contribution are therefore not substantial and are small in relation to the range of uncertainties surrounding the respective abilities of the Bidders to generate sales, as set out below.

### ***(iii) Marketing and sales plan***

Each Bidder was required to provide its overall plans for marketing the Lottery, with a rationale with supporting evidence for why its plans will maximise returns to good causes. Bidders were also asked to provide:

## Returns to good causes

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- Game plans: setting out their strategy, proposed game portfolio, details of individual games or class of game, and the forecast sales from each game;
- Player access plan: setting out plans for providing players with access to play the Lottery games – this could be through established retail channels and new channels.
- Plans for communicating to players, including brand strategy, advertising and promotion, public relations and broadcasting; and
- Marketing resource and sales plan: that demonstrates the organisational capability and resources to deliver the entirety of the marketing plans.

Camelot's overall strategy is to generate significant growth of the Lottery in years 1-3, through the enhancement of the existing portfolio of games, the introduction of a range of new games, improvements in sales through new channels and increased one-to-one marketing.

SDUK's overall strategy is initially to retain the current game portfolio and brand strategy, but create a stronger localised and targeted focus for marketing communications. This strategy would then evolve in response to consumer behaviour. Its Bid included increased retail penetration and a planned new game for years 1-3.

The Commission noted that Camelot, in support of its marketing and sales plan, had provided extensive evidence on most of the areas identified in the ITA. However, the Commission did not find all the evidence compelling. Whilst supporting evidence was provided for individual proposals, there was a lack of convincing evidence about their cumulative impact and likely interaction across the portfolio as a whole. In particular, the Commission was concerned that Camelot had adopted the more optimistic research forecasts for each proposal and adopted low forecasts for cannibalisation between the different proposals. In addition, the Commission considered that the degree of risk associated with some of the proposals, including the combination of the enhancement of the existing portfolio with the concurrent introduction of several new games in years 1 to 3, had been understated.

SDUK's response to the ITA, in support of its marketing and sales plan, provided limited supporting evidence. The Commission noted the way in which SDUK planned to take a measured approach to the development of new games, brand strategy and marketing communications. However, the Commission considered that the growth strategy proposed by SDUK did not address sufficiently the efforts required to maintain and enhance sales, particularly in Lotto. The Commission was therefore concerned that SDUK had underestimated the degree of active management in relation to marketing necessary to achieve the growth that SDUK forecast.

## Returns to good causes

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The evidence from both Bidders gives the Commission confidence that the funding for the staging of the Olympic and Paralympic Games in London in 2012 required in the third Licence Period can be achieved.

The Commission has considered the extent to which Bidders have fully taken into account the underlying trends in the Lottery and addressed the question of how far sales of new games or sales through new channels would displace sales of existing games or sales through existing channels. In addition, the Commission considered the evidence presented by Bidders on the issue of competition from outside the National Lottery. Having undertaken a careful analysis, the Commission considers there is a significant probability that each Bidder is over-optimistic about the proposals in its business plan and the revenue each would generate.

Once the relative strengths and weaknesses of the evidence provided by the Bidders in support of their sales forecasts had been taken into account, the key determinant was the assessment of which Bidder would be likely to deliver higher sales. The Commission concluded that there was a strong probability that Camelot would generate higher sales.

## Conclusion

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In the light of the considerations set out in this document, the Commission has concluded that both Camelot and SDUK met the Required Standards but that the Bid that is better able to maximise returns to good causes is Camelot's rather than SDUK's. The Commission has therefore selected Camelot as Preferred Bidder and SDUK as Reserve Bidder.

## End notes

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- <sup>i</sup> The Preferred Bidder is the Bidder with whom the Commission intends to finalise the Draft Licence.
- <sup>ii</sup> This statement discharges the duty of the Commission to give reasons for its decision under paragraph 9 of Schedule 2A of the National Lottery etc. Act 1993 (as amended). The licence includes the possibility of extensions beyond the initial Licence term. The ability of the Commission to grant extensions was conferred by the National Lottery Act 2006.
- <sup>iii</sup> The Commission will seek to finalise the Draft Licence and Enabling Agreement with the Preferred Bidder by the end of August 2007. The Enabling Agreement is the agreement to be entered into by the Commission and the Preferred Bidder governing the Transition Period. During finalisation of the Draft Licence, the Preferred Bidder will be required to secure any consents, approvals or other conditions that may be required. Once the Commission is satisfied that these consents have been obtained, it will award the Licence.
- <sup>iv</sup> A Reserve Bidder is the Bidder with whom the Commission would intend to finalise the Draft Licence in the event that finalisation of the Draft Licence were not achieved with the Preferred Bidder.
- <sup>v</sup> Returns to good causes include those to the National Lottery Distribution Fund and the Olympic Lottery Distribution Fund.
- <sup>vi</sup> Transition includes the process of preparing for, and the start-up of, operations. This includes the launch of all games in the initial portfolio, acquisition of premises and facilities, appointment of all suppliers, recruitment and training of staff, establishing all the planned retail outlets, and implementing systems and distribution channels. It also includes any activities relating to Handover from the Current Operator, in the event that the Successful Bidder is not the Current Operator, together with any associated transfer of assets, people, data, contracts, rights and other aspects of the current operation. This occurs at the expiry of the current licence period and start of the new Licence Period.
- <sup>vii</sup> Documents relating to the Licence competition can be found at [www.natlotcomm.gov.uk](http://www.natlotcomm.gov.uk).
- <sup>viii</sup> The ITA made clear that no amendment, either upwards or downwards, may be made to a Bidder's principal forecast, retention rates and hence forecast contributions to good causes at any time after the Bid had been submitted. The evidence considered by the Commission included: the Bids as submitted on 9 February 2007; information provided by Bidders

## End notes

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as part of the clarification or modifications processes; information provided as part of presentations (the Commission invited Bidders to make initial and detailed presentations); and visits made to operations where services are being provided by Bidders or their Consortium members in order to assist its evaluation.

- <sup>ix</sup> The Commission adopted a Common Sales Scenario that assumes growth of one per cent per annum in Lottery sales from end 2005 to 2019 after correcting for the impact of inflation. The Common Sales Scenario was not intended to represent the Commission's own forecast, or an indication of the outcome the Commission considers most likely. Instead it was designed to assist the evaluation of each Bidder's business plan and returns to good causes.
- <sup>x</sup> The ITA stated that the Principal Forecast must represent the version of the business plan that best represents each Bidder's view of the financial projections that result as a consequence of the proposals set out in its Bid. The marketing plans should demonstrate: grounding in an understanding of the Lottery; balance of core and innovation; deliverability; and robustness. The Commission recognises that it is increasingly difficult to predict technology, consumer/player behaviour and competition in the later years of the Licence Period. It has, therefore, made the distinction between years 1-3 of the Licence, where more detail on plans is required, and years 4-10, where less detail is required.
- <sup>xi</sup> This figure includes SDUK's commitment to contribute any profits in excess of 1% of sales to good causes.





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