

CULTURE, TOURISM, EUROPE AND EXTERNAL AFFAIRS COMMITTEE

ARTS FUNDING INQUIRY

SUBMISSION FROM CAMELOT UK LOTTERIES LTD.

What are the major threats to sustainable funding of the arts in Scotland?

As the Committee notes in its call for evidence “*the reliability of the National Lottery as a secure source of funding for the arts in Scotland will arguably depend on future ticket sales, as well as developments in the wider UK lottery market, including regulation and promotion of society lotteries*”. In this submission Camelot, operator of The National Lottery, will argue that proposals from the UK Government to reform society lottery regulations are a major threat to sustainable funding of the arts in Scotland and that large-scale ‘synthetic’ national lotteries have already harmed returns to National Lottery Good Causes.

Introduction to The National Lottery and Camelot

The National Lottery

When proposing the establishment of The National Lottery in 1992, Prime Minister John Major said:

“[The Government] will introduce legislation to create a single national lottery. Hundreds of millions of pounds will be raised to foster the arts, to encourage sport and to sustain our voluntary bodies. It will provide funding on a hitherto unprecedented scale. It will improve massively our arts and sports facilities. It will help to preserve our heritage and perhaps create new buildings for us to hand on to our children. It will help support the network of voluntary bodies of which this country can be so proud, and with which it is uniquely blessed.”¹

The National Lottery has been an undoubted success since it was launched in 1994. Funding raised by The National Lottery for Good Causes benefits a hugely diverse range of sectors. In total, 535,000 individual awards have been made over 24 years – an average of 190 lottery grants for each postcode district, totalling over £39 billion.

Camelot

Camelot has been the licensed operator of The National Lottery since its introduction in 1994, and the current Licence runs until January 2023 meaning that we have almost 25 years’ experience of responsibly operating a national asset and one of the most successful lotteries in the world. Camelot’s overarching objective is to maximise returns to National Lottery Good Causes through selling lottery products in an efficient and socially-responsible way. While we are responsible for generating returns to Good Causes, Camelot plays no role in the allocation of Good Cause funding. This is the specific responsibility of 12 lottery distribution bodies, each with specialist knowledge of their sectors.

Sales of National Lottery products have now seen two years of growth following the programme of activity undertaken as a result of Camelot’s strategic review in 2016/17. The four principles of the strategic review were: improving the range of games; investing to enhance the retail offering; upgrading digital capabilities; and reinvigorating The National Lottery brand. We are working tirelessly to maintain this upward trend, and part of this is

¹ Mr John Major, Queen’s Speech, House of Commons Debates, 6 May 1992 , c.72

working with Government to ensure that the policy and regulatory environment allows The National Lottery to flourish.

The single national lottery model

The success of the UK National Lottery over the past 24 years is a direct result of the single National Lottery model. At launch, a single national lottery under government licence was deemed the most efficient way to ensure the protection of players, the fitness and propriety of operation, and the maximisation of returns to Good Causes and society. There was to be a clear and complementary distinction between The National Lottery, offering life-changing prizes and smaller traditional society lotteries, fundraising for local good causes. The theory and practice of this model has been revisited by government and policy-makers a number of times, and it remains the most effective method of maximising returns to Good Causes.

In recent years the emergence of ‘synthetic’ national lotteries – i.e. the Health Lottery and the People’s Postcode Lottery – has blurred the distinction between The National Lottery and society lotteries. These larger lotteries are sold and advertised under a single ‘umbrella’ brand, available to buy nationally and run by commercial operators. ‘Synthetic’ national lotteries clearly encroach into the territory originally intended by Parliament to be the sole preserve of The National Lottery, challenging the established policy principle that there should only be one national lottery to ensure maximum benefit to society. In this way, the single National Lottery model has been undermined by the substantial growth of ‘synthetic’ national lotteries, impacting returns to National Lottery Good Causes. We believe this will be exacerbated further by the implementation of the changes proposed by the UK Government to society lottery regulations, as set out below.

UK Government Proposals for Society Lottery Reform

As the Committee is aware, the Department for Digital, Culture, Media and Sport (DCMS) consulted over summer 2018 on proposals for society lottery reform. The preferred options set out by DCMS were to increase limits on society lottery prizes and proceeds, enabling them to offer prizes of £500,000 (currently £400,000), with annual proceeds of £100 million (up from £10 million) and per draw sales limits of £5 million (up from £4 million). DCMS based these proposals on policy advice from the Gambling Commission (provided in 2015 and 2016, then reviewed in 2017).

Camelot’s submission to the consultation set out our opposition to the proposals on the grounds that:

- The Gambling Commission’s advice to DCMS, which stated that there would be no harm to The National Lottery as a result of the proposed changes, is incomplete and out-of-date – for example it does not take into account the significant growth of ‘synthetic’ national lotteries over the past five years under the current prize and proceed limits.
- There is already clear evidence of harm to The National Lottery from ‘synthetic’ national lotteries.
- The ‘synthetic’ national lotteries have created a marketing ‘arms race’ which is currently affecting The National Lottery and returns to Good Causes.

Creative Scotland, the public body that supports the arts, screen and creative industries in Scotland, likewise submitted a response to the consultation, opposing the DCMS proposals

due to their concerns about the funding for arts and culture in Scotland. The response from Creative Scotland is noted in this call for evidence, and states that:

“National Lottery income is critical to the strength and vibrancy of culture in Scotland and anything that might impact on this income is of great interest to everyone who works in or cares about creativity in Scotland.”...

“In recent years, the National Lottery has been under pressure, including from increased competition from Society Lotteries, which has impacted negatively on the amount of money available to good cause through National Lottery proceeds.” ...

“Creative Scotland does not support the preferred options set out in the consultation and are particularly concerned that, if actioned, these options will have a detrimental impact on the levels of funding available for the arts, screen and creative industries – and other good causes – through the National Lottery in Scotland.”²

There has already been harm to The National Lottery from competition

Economic analysis

We believe there is evidence that ‘synthetic’ national lotteries have already had a negative impact on The National Lottery and returns to Good Causes. The Gambling Commission’s advice provided to DCMS found that *“there is little evidence of ‘harm’ to the National Lottery at the current prize level”³* for society lotteries and that large society lotteries *“unlikely to have made a significant impact”⁴* on The National Lottery. However this is refuted by more recent economic analysis.

We asked Frontier Economics (Frontier) to analyse of the effect of competition on National Lottery sales, and to consider the future impact of competition on The National Lottery over the rest of the current Licence period. This analysis shows that, contrary to the Gambling Commission’s view, competition *has* had a negative impact on National Lottery sales compared to what they would have been otherwise. Frontier estimates that National Lottery sales have been cannibalised by £703 million as a result of competition over the period 2011 to 2017, leading to a reduction in National Lottery returns to society of £266 million over the same period.

New evidence

Since the Government formed its view on the proposed changes to society lottery regulation, important new information has come to light. Looking at changes to the People’s Postcode Lottery Terms and Conditions and prize funds available to players, we estimate that their sales grew by c. £150m in 2018/19, a sum greater than their entire revenue when the Gambling Commission’s policy advice to DCMS was initially assembled in 2015. With compound annual growth rates of between 30-50% and now with annual sales of c. £450m in 2018/19, this proves beyond doubt that the People’s Postcode Lottery is no longer a society lottery but a ‘synthetic’ national lottery operating nationwide.

International evidence

We also believe it is illustrative to look at evidence from the Netherlands, where the two state national lotteries were forced to merge in order to try and compete with the Dutch People’s Postcode Lottery. In spite of actions taken by the state-owned operators, the

² Creative Scotland, Consultation on Society Lottery Reform: response from Creative Scotland, September 2018, p.3 & 4

³ Gambling Commission, Advice provided to DCMS on society lotteries, pub. 2018, p.7

⁴ Ibid, p.2

Dutch People's Postcode Lottery is now larger by sales than the merged state lottery, having displaced the national lottery as the dominant market player.

Marketing 'arms race'

Beyond the negative impact on sales identified by Frontier, the competitive market created by 'synthetic' national lotteries – and the People's Postcode Lottery in particular – has forced The National Lottery to spend more on marketing in order to compete. In the next financial year The National Lottery will spend 180% more on media in than it did in 2010 for approximately half the advertising share of voice it once enjoyed. Given that The National Lottery is licensed as a 'single operator', it follows that it should command a strong majority share of voice in lottery marketing – prior to the growth of 'synthetic' national lotteries The National Lottery enjoyed a share of voice of around 85%.

The result has been to establish a marketing 'arms race' in which The National Lottery is forced to compete for share of voice in a market designed around the economically-efficient model of a 'single National Lottery operator', inflating its marketing costs and driving a cycle of inefficiency at the expense of National Lottery returns to Good Causes and society. This is possible because 'synthetic' national lotteries are subject to light-touch regulation intended for small-scale traditional charity lotteries.

Reintroduce an expenses cap for 'synthetic' national lotteries

These high levels of marketing spend by 'synthetic' national lotteries are possible because, since the Gambling Act 2005 ('The Act') came into force they have been free to spend unrestricted amounts of lottery revenue on overheads, including marketing. The Act removed the cap on expenses at 15% for large society lotteries, instead requiring all expenses to be "reasonable" and setting a minimum return to good causes of 20%. By comparison, The National Lottery retains only 5% of turnover for operating costs, including marketing and returns to the shareholder (at around 1%). This disparity in expenses distorts the lotteries ecosystem, preventing it from operating in the way in which it was designed to function under the single national lottery model, and resulting in suboptimal returns to society.

The negative effects for society of this marketing 'arms race' supports the case for the reintroduction of an expenses cap for 'synthetic' national lotteries at between 5-10% of turnover. For the avoidance of doubt, we are not suggesting that the expenses cap applies to traditional society lotteries – only to 'synthetic' national lotteries.

Fourth Licence Competition

The competition for the fourth Licence to operate The National Lottery commences this year (2019). We believe that the proposed changes to the society lottery regulations are very damaging to the long term value of a hugely successful national asset and could weaken the fourth Licence competition process. Without clarity around the future regulation of the lotteries ecosystem and with the full impact of these proposed reforms unclear in the near and long term based on the evidence provided, there are a number of potentially undesirable outcomes. These include increased complexity, and bidders raising prices to adjust for competitive market uncertainty, with the potential for this to result in a reduction in overall returns to society in the long term.

Reforming the taxation regime of The National Lottery

Alongside increased direct competition in the lotteries market from 'synthetic' national lotteries, the wider market in which The National Lottery operates has transformed

significantly in recent years. Over time, all major gaming and gambling sectors have been moved to a Gross Profits Tax (or equivalent), while The National Lottery remains an outlier taxed on turnover – Lottery Duty. This tax regime restricts The National Lottery's capacity to respond to the changing market dynamics and its ability to compete on price or value. Camelot believes that migrating The National Lottery to a Gross Profits Tax would help to meet our overarching objective of maximising returns to National Lottery Good Causes through selling lottery products in an efficient and socially-responsible way.

With the competition for the Fourth Licence approaching, this is the right time to consider The National Lottery's tax regime, providing clarity for all potential bidders. In the increasingly competitive market within which The National Lottery operates, a move to a Gross Profits Tax could be a key factor in ensuring its current and future health. Introducing a Gross Profits Tax would support The National Lottery's ability to serve Good Causes for both the remainder of the third Licence and into the fourth. We have been in positive dialogue with HM Treasury on this matter.

Conclusion

Camelot believes that the UK Government proposals to increase prize, proceed and draw limits for 'synthetic' national lotteries are a major threat to sustainable funding for the arts in Scotland, and indeed all National Lottery Good Causes. Moreover, we believe that in order to safeguard The National Lottery and protect returns to Good Causes, an expenses cap should be introduced for the largest 'synthetic' national lotteries, reflecting the scale at which they now operate. As the experience of the Dutch state lottery demonstrates, the consequences for not doing can be very serious for national lotteries and the funds they raise for society.

What measures could the Scottish Government take to ensure a sustainable level of funding for the arts?

In light of our submission, Camelot calls on the Scottish Government to:

- Oppose UK Government proposals for society lottery reform and support the reintroduction of an expenses cap for 'synthetic' national lotteries.
- Support the migration of The National Lottery from a Lottery Duty regime to a Gross Profits Tax.