Revenue Cycle Management for Software Companies

Understanding Your Company's Processes and Needs

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For software companies, the sales, billing and revenue management processes may sometimes evolve in a less-than-optimal way, for a variety of reasons. Over time, the complexities involved may compound, leading to inefficiency, lack of visibility, and compliance issues. The goal of this discussion is to provide a framework for understanding these processes – how they interact at your company – and how these processes influence your revenue cycle management needs.

Although "revenue cycle management" has a specialized meaning in the healthcare industry, we use it here to describe the business process that starts with a sale, includes billing and customer financial management and then continues through revenue recognition. This process also includes both the quote-to-cash process and customer transaction management.

HOW WELL DOES YOUR COMPANY CURRENTLY HANDLE REVENUE CYCLE MANAGEMENT?

Below are some questions that will help you to quantify your current processes as well as target your company's specific areas of concern:

- How much time is it taking you to compute revenue? Are you spending more time calculating what revenue should be than analyzing what revenue actually is?
- How confident are you in the numbers that you're posting?
- How much time is it taking you to fix mistakes in your revenue computations?
- Are you confident you'll find the mistakes in your revenue recognition?
- How much risk exists related to your revenue accuracy?
- How easy is it to forecast and analyze your current and deferred revenue?
- Do you under-report revenue or delay recognition of revenue because you want to be cautious or because you want more time to review or get a handle on the data?

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Revenue Cycle Management Drivers

OVERVIEW

Sales Process

- Direct, indirect (channel), or hybrid process?
- High-touch or low-touch?
- Level of customer engagement – e-commerce, contract?

Billing Process

- Matched to – or independent of – the sales process?
- Service, product, transaction, renewal or usage-based?

Revenue Process

- Matched to – or independent of – billing?
- Compliance requirements?
- Event-based, amortized, timing-based or activation-based?

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To accurately uncover your company's needs, it pays to step back from specific issues and take an in-depth look at the processes behind revenue cycle management:

- Sales process
- Billing process
- Revenue process

In the sales process, we're going to look at the mechanics of the sale: What actually occurs in the sales process – the mechanical or concrete steps of the sales process? What type of interaction exists with that customer at the end of the sale or the start of the process?

In terms of the billing process, what are the complexities of the terms or the relationship related to execution and delivery?

And in the revenue process, it's important to ask: What disclosed revenue policies and accounting standards are involved?

Sales Process Questions

OVERVIEW

How do you interact with your customers?

- Direct Interaction? Website or salesperson?
- Indirect or channel model? Describe this process.

What governs customer transactions?

- Detailed and multi-part contract?
- Internally built web platform?
- Basic sale plus renewals?

How interactive is the ongoing relationship?

- Frequent additive sales?
- Frequent discrete / independent sales?
- One and done?

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Once you've examined the process, we then look at its pieces – again through a series of questions. Answering these questions will give you a good picture of your company's unique sales process.

The first question is: How do you interact with your customers? Is there direct interaction? Is there a salesperson making a call? Do people find you on a website? Do you sell through a channel? (And you should know that if you sell through a channel, this can actually be a more complex revenue cycle than a direct sale.) These questions can help you to describe your processes and help you to capture how you interact with your customers at a high level in terms of how this affects the revenue cycle.

The second question: What governs the transactions with your customers? is also key. Do you have a detailed, high-touch contract that specifically defines the customer relationship engagement? Is it a low-touch: "Come to our website" approach, where website captures the customer management information as part of the process? Is it an agreement with a sales order for execution? Or, is your customer transaction a hybrid process incorporating several of these factors? Bottom line: What documents and/or actions govern transactions?

And thirdly: How interactive is your relationship? Is it: "We make the relationship and close the deal and we're done?" Can the customer change his or her mind? Do they add and subtract things? Is this a discreet or an additive sale? Basically, how do you manage this relationship, once it exists?

The answers to these questions will illuminate the customer transaction from a management perspective: How do we move from a relationship to building and winning the account and finally on to the customer transaction? How do we manage the financial transaction between our company and our customers?

Sales Process: Product and Process Questions

OVERVIEW

How would you describe your product offering?

- High-dollar products with a high touch process?
- Low-dollar products with a low touch process?
- Low-dollar products with a high touch process?

What do you sell?

- Services + products?
- Multiple service types?
- Related services and products?
- Is this a physical product or IP based product?

Related to the sale are also key questions you can ask yourself related to what you sell, which can help you get to the heart of defining the requirements. *NOTE: There are winning strategies in all of these areas, so this is not any one right strategy. These are simply questions to help you determine your strategy.*

Question #1: How would you describe your product offering? Is it a high-dollar, high-touch process? Does my company make ten sales per year for $100 million? Or, do I need a million sales to make $100 million? Detailing the answers to these questions will help you to understand the nature of your process. For instance, you don't want a low-touch process that has a high administrative requirement for customer transaction or revenue cycle management. Low-dollar, low-touch processes should emphasize efficiency in the sales process, which minimizes the sales effort to maximize profitability.

Question #2: What do you sell? Do you sell a service plus product? Multiple service types? Or multiple service streams? Do the services interact with each other? Or are they all independent services? Do you sell something that's intellectual property? Is there a royalty? Is it a physical product? A short description of the kind of SKUs and part numbers for each product offering will go a long way towards helping you determine your requirements. You'll need to document the way in which you react as well as how you sell the product.

Billing Questions

OVERVIEW

What triggers a billing event?

- Shipment of product?
- Use of service?
- Contractual terms?
- Renewable agreement?

How do you manage your billing process?

- Service tracking systems matched to contract?
- General support services?
- Customer order to fulfillment?

In terms of billing questions, what we're looking for here are triggers for billing events. How do you manage your billing process? Again, these are questions that – if documented – will help you to build an accurate set of requirements.

Question #1: What triggers a billing event? Is it the sale itself? Is it the shipment of a product? Is it the use of the service? Is it the contracts? Is it renewable? Is it an ongoing, forever type of thing?

Question #2: How do you manage your billing process? What is it that triggers billing events in your company? (The events can be all the way from very complex to very simple.) How do you currently manage your billing process? Is it in terms of people and administrative time? Do you currently have a system that tracks utilization? If you bill by usage, how do you collect that usage fee? Is there a match between the service provision and the billing? Or is the billing independent, like in a support contract or maintenance agreement? Is the billing process an order-to-fulfillment – where shipment triggers billing? Or is it a combination of things, such as billing-on-shipment, billing-on-delivery, billing-on-execution, etc.? So we've defined what parts are sold, how they're sold and how we interact with our customers. Now, we need to categorize how we bill separately from how we sell.

Revenue Questions

OVERVIEW

What triggers revenue recognition?

- Tied to billing or separate from billing?
- Tied to fulfillment or service provision?
- Tied to channel fulfillment or service provision?
- Associated with a period of time?

What compliance objectives do you have?

- SOP or EITF Standards?
- Published company or auditor approved policies?
- SOX or public company standards?

The final set of questions is related to documenting your revenue cycle. Some of these questions are related directly to revenue. Others relate to events that trigger revenue and others will help to determine compliance objectives. Is revenue tied to billing or separate from it? Is it tied to service or activation? Is it tied to a period of time? Are there exceptions that trigger revenue recognition that fall out of the other revenue recognition rules? Trying to capture these revenue triggers that are independent of the billing and sales triggers, one may find that they're all related to each other – or they may all be independent. But ultimately, these questions will give you an accurate picture of your revenue requirements.

Additionally, compliance objectives are very important for establishing revenue – SOP standards or EITF standards – for instance. Do you have specific evidence standard requirements? Do you have published company – or auditor-required policies that you need to demonstrate? Do you have Sarbanes-Oxley or public company standards with which to comply, where you need to demonstrate that you have integration and/or control of your process? Are you confident in executive-level signoff that the revenue is accurate and risks are minimized?

So in summary, understanding your company's compliance objectives and revenue triggers will help you to see what your company's revenue recognition targets should look like.

Company Requirement Scenarios

OVERVIEW - SCENARIO 1

Sales Model

- Direct or High Touch Indirect Sale
- Contractual Commitments defined
- Customer change management required

Billing Model

- Multiple SKUs or Contract lines
- Multiple billing methods possible

Revenue Model

- Potential relationship between billings events
- Policy, Standards, and Contract Compliance
- Revenue separate or related to billing

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Now that you've reviewed all of the questions and commentary outlined in this document and are beginning to formulate answers based on your own company, take a look at the following example company requirement scenarios, which may look familiar or may simply spark some further questions. Based on real-world experience with our own customers, these scenarios will help you to see some of the intricacies and complexities that go into revenue cycle management, and why better management of this these processes is so important to your company's success and profitability.

SCENARIO 1 – ENTERPRISE AGREEMENT

The first scenario describes a set of company requirements that we'll call "**Contract-Based**." The contract-based scenario typically involves a direct sale or a high-touch indirect sale. By indirect we mean that you may have a third party that sells the product for you, but when the sale is actually made, the contract is directly with your company, not with the third party. In effect, this means that your channel is an extension of your company. There are contract-level commitments between the customer and your company. There is also change management required in this scenario. The customer may add to co-terminus agreements or multiple additions to the same contract process.

The **billing model** for this scenario must support multiple SKUs (contract lines), sometimes hundreds of contract lines. Or there may be multiple billing methods, so some are renewable, some execution-based, some license-based, and so on. This model has many working parts – some of which may relate to each other.

In terms of the **revenue model** for this scenario, it's not uncommon to have the revenue be completely separate from the billing, where revenue is based on contractual commitments instead of billing. Or, it's based on company policy or your compliance requirements. Whatever the circumstances, there are a number of things that the revenue model can be separate from or based on, depending upon the relationship between billing models.

In summary, companies with these types of needs can include enterprise software companies, business service firms, business process outsourcers, companies that sell software plus services. Enterprises that have a high degree of interaction between the customer and what's actually delivered fit this model.

OVERVIEW - SCENARIO 2

Sales Model

- Website-based sale
- Frequently low-touch sales model

Billing Model

- Based on renewal terms
- Possibly based on usage

Revenue Model

- Amortization and/or usage-based
- Revenue follows billing and SKU
- Exception management is important

SCENARIO 2 – SUBSCRIPTION-BASED

The **selling model** in the "Subscription-Based" scenario might be thought of as the online media or Web 2.0 model. The subscription model is usually a website-based, low-touch sale, related to a large number of subscription transactions. In this sales model, the challenge is to find the lowest-touch method to effectively manage your sales transaction process.

The **billing model** is normally amortization, either based on renewal, or usage, or some sort of generalized rules.

The **revenue model** usually follows billing or follows rules related to part numbers – rather than a contract. In this scenario, exception management becomes very important. Companies that have subscription models may have rules that say: "Your revenue starts 30 days after customer signup," assuming that fulfillment activities have happened within that time frame and the revenue should then start. Or, "If they haven't started within 180 days . . . start the revenue anyway." So the exceptions are actually for customers who make less-than-optimum use of a subscription. Accurate exception management can generate a huge amount of money in this type of model. Additionally, efficient and productive exception management can be a very efficient way to collate, analyze, give visibility to, and automate data in this process.

Company Requirement Scenarios

OVERVIEW - SCENARIO 3

Sales Model

- Channel or OEM Sales
- Channel sales may combine with customer activation
- Channel reporting important to sales process

Billing Model

- Billing is not to the end customer
- Billing may be based on contract or account rules

Revenue Model

- Revenue can be based on end customer use
- Revenue can be based on channel reporting
- Consigned material sell through

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SCENARIO 3 – SELL-THROUGH

The “Sell-Through” **sales model** refers to interacting with customers through reseller channels. Companies that sell technology products through a channel, a distributor or a reseller follow this model, as well as companies that sell through an integrator, and online gaming companies that sell based upon customer activation. Companies that use OEM sales or media sales that involve royalty payments also can fit here. The model itself has a sale through a channel or an OEM (an OEM being an embedded sale where you might give your IP to someone and they pay you a royalty for every time they install it on their product.)

Channel sales may combine with customer activation, but basically the important initial relationship is between you and the channel, and the end-customer is one step removed from your company. This means that the channel reports back to you on what they sold. The information on who bought that product becomes very important in this type of sale. The challenge is: How do you integrate channel sales information into your sales model and how does that follow through into the billing revenue models?

The **billing model** for this scenario is not to the end customer. It’s to the channel or to an OEM. It could be based upon a contract or the account rules. So, if it’s an OEM sale or a royalty sale, questions arise such as: How does your contract define minimum payments? What is the cost-per-usage level? How much did you use? What sort of invoice should we create, based on the contract terms and the royalties which are being reported? How do I look at what you sold or what you’ve ordered from me, and how should I bill you based on that information? Many times, there are contracts in this model that define the channel relationship – but not the end-customer relationship.

The **revenue model** for this scenario can either be based on the end-customer or on the channel. It can be based on channel acknowledgement of a sale to an end-customer without you knowing who the end-customer is. Or we can have what can be described as "two-cycle revenue management," where there is a sale to the channel and the channel reports that a sale has been made, but until the customer activates – either on your website or by some other means – the final revenue amortization doesn’t begin.

Revenue Cycle Management Solution Options

Here are several ways that companies try to address the needs that we've been discussing:

- **SPREADSHEETS:** Spreadsheets are very flexible and easy to get started, but then at the same time, highly error-prone. In fact, almost everyone pushes the limits of spreadsheets when first attempting to do revenue management. But studies have shown that any spreadsheet that has more than 100 lines has an error in it. So, the spreadsheet's flexibility is offset by lack of integration, lack of scalability and frequently variable user rules as opposed to stable system-managed rules.

- **CUSTOM APPLICATIONS:** People build homegrown solutions in everything from Access databases to the programming language that their core financial and accounting solution was written in. The key disadvantages of these are that they tend to be very expensive to build and maintain well; they typically complicate upgrades; and, they suffer from a user community of only one company, so industry best practices are lacking.

- **POINT SOLUTIONS:** These are stand-alone systems with little or no integration with your company's GL, payables or receivables.

- **INDUSTRY-SPECIFIC ERP:** This category is where you find the Tensoft Revenue Cycle (RCM) Management/ERP solutions. Tensoft RCM products are built to integrate to ERP, creating seamless end-to-end system revenue cycle management and financial reporting. Tensoft has deep experience supporting integrated solutions in the ERP world, leveraging the solid technology stack, so that you have one end-to-end, integrated solution that specifically meets the needs of companies that have complex revenue management needs.

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The Tensoft Strategy for Software Companies' Success

For over ten years, Tensoft has been active in the technology industry, supporting clients, observing industry developments, and developing strategies for businesses to succeed. Tensoft clients include enterprise software publishers, Software-as-a-Service providers, Web 2.0 companies, video and online game developers, and more. Tensoft has been successful at helping these companies navigate and thrive levering integrated ERP solutions and effective change management processes.

TENSOFT RCM, A COMPLEMENT TO YOUR ERP SYSTEM

Tensoft Revenue Cycle Management supports the software industries most critical and complex needs including revenue, billing, and contract management. Combined with core financial and reporting capabilities from ERP systems, Tensoft RCM provides robust, industry-specific functionality that's been specifically designed for the needs of software companies.

For many software companies, contract data drives accounting processes, but is often disconnected from key processes at the system level. Tensoft Revenue Cycle Management provides one central location – and one integrated system – which automates your lifecycle business processes such as billing and managing contract renewals, and your advanced financial management processes such as revenue recognition and management.

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Benefits of using Tensoft Revenue Cycle Management

- **STREAMLINED PROCESSES** – Fully integrated, definable revenue processes speed revenue recognition and accounting close. Centrally entered data standardizes the information that's captured, and web-enabled screens help multiple users get the information they need, quickly
- **LESS REVENUE LEAKAGE** – Contract details drive revenue rules in Tensoft RCM, and users can build billing schedules to prevent late or forgotten billings. Gain revenue lost in manual tracking. Eliminate errors, lack of detail, and duplicate entry.
- **FACILITATE COMPLEX BILLING** – Allows you to control unbilled revenue, automate recurring billing, and easily schedule future billings.
- **SIMPLIFY REGULATORY COMPLIANCE** - Supports AICPA, FASB and SEC regulations, and SOX Section 404 requirements. Speed audits with complete transaction history, detailed reporting, and controlled processes.
- **LEVERAGE THE FINANCIAL TEAM** - Decrease the cost of tracking and managing revenue, so you can focus on analysis and process instead.
- **DELIVER KEY FINANCIAL METRICS** - Efficient, real-time reporting for quick answers to business-critical questions.
- **STREAMLINE AUDIT SUPPORT** – Audit trails are maintained between the ERP system and Tensoft RCM, and a notes field enables reference to the original and subsequent contracts.
- **IMPROVE EFFICIENCY** – Automates delivery of financial measures such as how much revenue remains on each contract; how much revenue is recognized; how many revisions have been made to a contract, etc.

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Key Features of Tensoft RCM Software

Tensoft RCM captures critical information regarding contract data in a central repository that integrates seamlessly with financial and accounting system and processes. As a result, accounting processes become substantially more efficient, providing management with greater insight into current and future revenue streams.

- Separation of billing and revenue recognition
- Revenue is booked and recognized in the appropriate fiscal accounting periods, according to accounting practices and regulations
- Automates handling of multi-element contracts
- Business models and customer billing can be customized by account
- Supports carve-outs
- Handles co-terminus agreements
- Automatic pricing based on contractual terms can be applied to any line item
- Creates rules to eliminate errors
- Accurate and consistent revenue booking
- Supports different contract models:
    - Sell-through model
    - Sell-to model
    - Subscription model
    - License model
- Tracks contract revisions
- Contracts that have multiple elements and numerous revenue streams are assigned appropriate allocation and recognition schedules according to your business rules
- Allows multiple revenue methods:
    - Short-term method
    - Straight-line method
    - Acceptance-based method
    - Consumption method
- Supports billings based on usage
- Access to detailed reports and audit trails, with visibility into revenue schedules to enable proactive revenue management
- Pre-payment management
- Revenue forecasting
- Transactional audit trail and reporting tools
- Supports compliance with SOP 97-2, EITF 08-01 and other revenue recognition rules

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Conclusion

FOR MORE INFORMATION

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Together, Tensoft Revenue Cycle Management and a solid ERP system provide industry-specific functionality for software companies, as well as a world-class business management solution, tightly integrated with the office production tools used by most companies today. Microsoft supports ISV Partners like Tensoft and actively markets solutions like Tensoft's Revenue Cycle Management, to better meet the needs of their software industry customers.

As you consider implementing Tensoft Revenue Cycle Management, think about what goals this solution might help you achieve. Remember that the value of your investment in today's powerful products will be maintained and increased by Microsoft and Tensoft's long-term vision and unwavering commitment to research and development, backed up by significant resources.