I D C A N A L Y S T C O N N E C T I O N

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Why Enterprise Revenue Life-Cycle Management Is Ready for Prime Time

January 2015

Enterprise revenue life-cycle management (ERLM) is a class of software that can manage all of the processes between when a deal is booked and its final accounting as reported in financial statements. Currently, most companies are using less-than-optimal approaches, such as a combination of spreadsheets and custom database applications, to manage the processes that ERLM addresses. New ERLM systems can help companies meet challenges from the new guidelines that FASB and IASB published in May 2014. Henceforth, more companies across a variety of industries will need to prepare for compliance. From new reporting requirements to disclosure of judgment applied to justification of estimates, the systematic approach of an ERLM application is the future path of finance organizations.

The following questions were posed by Revstream Inc., provider of a cloud-based platform for enterprise revenue life-cycle management and automation, to Christine Dover, research director for IDC's Enterprise Applications and Digital Commerce program, on behalf of Revstream's customers.

Q. What is ERLM, and what are its benefits?

A. Revenue is a complex topic. If a deal is sold that is worth $1 million, that's not the same as revenue into the company. There are many rules about how revenue is recognized. Companies need to manage their revenue life cycle just as closely as they manage their sales pipeline, product production, talent, and other areas that make up their business. New applications are being developed to optimize ERLM. It's really a problem of the "middle office." Historically, we've had back-office apps such as accounting and order management and front-office apps such as sales automation. But there's a lot that happens in between the front office, where the sales rep "books" the order, and the back office, where the order is accounted for and fulfilled. Also, much of the burden of revenue recognition in the past few years has been on the technology industry, whereas the new standards will affect companies across many industries.

The term "enterprise revenue life-cycle management" is used because revenue is being managed and earned over a period of time. Once a deal is sold, revenue may come in based on certain milestones such as product deliveries. There may be contract terms and conditions that dictate how and when revenue is recognized. Sales contracts often have terms and conditions that reveal future deliverables that were included for no additional cost (e.g., free-of-charge items that create revenue recognition issues) or contingencies for future price increases or decreases. For example, the deal may have included a bundled offering of product, services, a "free" warranty, and a discount coupon for a future purchase. All of these components need to be unbundled, and the revenue for each needs to be managed separately. Also, many companies are offering their products and services on a recurring revenue model, which means the deal may be booked and paid for up front and then a portion of the revenue is recognized over a period of time. This end-to-end process can be described as "contract to revenue" (C2R).

Another complication is billing, which is an independent process and often occurs on a separate schedule. ERLM applications manage the processes that happen between the contracting of the deal and the final accounting reported in financial statements. Because financial reporting places a heavy emphasis on revenue and its characteristics (e.g., level, trend, and volatility), companies that incorrectly report revenue often find their enterprise value damaged in the eyes of the investment community. Leveraging ERLM provides a number of benefits, including a system of record for revenue, reduced dependence on manual processes and spreadsheets for managing revenue, minimized financial risks of restatement and noncompliance, and real-time insight into the effectiveness of pricing strategies.

Q. Why are current approaches to revenue management not doing the job? Why has no one solved this problem in the past?

A. Currently, many companies are making do with spreadsheets and extra staff, building custom applications, or using their ERP system. Many financial accounting applications have included some functionality for revenue recognition but generally not the complete process of ERLM. Spreadsheets can certainly work for a while but quickly become unmanageable as the company grows and revenue activity increases. Spreadsheets also create other issues because multiple individuals working with them will often make inconsistent decisions that result in errors. Spreadsheets also have version control issues and are generally not auditable.

ERLM is an advanced feature for many financial and accounting applications. Upstream processes such as quoting, contracting, and ordering were designed to facilitate order taking and billing while ignoring the information structure and data needed in the revenue accounting processes. In addition, the size of the potential ERLM market was not compelling enough for software providers. That's changing with the new guidance on revenue recognition. Most companies will be subject to the new guidelines that will be in effect throughout 2017.

Q. What are the implications of the new guidance on revenue recognition?

A. Previously, revenue recognition was mostly a high-tech industry problem. The new FASB and IASB guidance eliminated many of the differences in favor of a single comprehensive model that focuses on broad principles. As a result, more companies in more industries need to comply with revenue recognition guidance, and that places a greater reliance on professional judgment to interpret what the rules mean. This makes a modern configurable system a necessity.

There are new rules defining when revenue is recognized, constraints on revenue that applies to variable consideration (e.g., rebates, refunds, credits, and incentives), accounting for long-term contracts, accounting for licenses or right to use, and more. The new rules are effective for annual reporting periods beginning after December 15, 2016. But it is essential that companies start considering how they will meet the new guidelines because implementing a new system will require significant lead time. The cost and risk of waiting to make a decision or doing nothing about how your company will manage the guidelines far outweigh the cost of implementing a solution. Noncompliance, or choosing to delay, is usually not an option because it risks damage to the enterprise's reputation as well as loss of investor confidence.

Q. What are the key challenges and considerations in implementing ERLM solutions in the enterprise?

A. Implementing any system can be challenging. Companies need to consider not just the software they are implementing but also the project team, change management, impact on other systems, processes and priorities, and more. What's different about ERLM is that the data needed to manage revenue processes may not be readily available or prepared, or it may be of poor quality. This means that the project team may need to devote extra resources to data collection and cleansing.

Another consideration is the subjective judgment needed to determine how the guidance rules impact your company. This means that each implementation is unique. While software vendors may offer industry-specific best practices, make sure your advisory team reviews these and validates that the setup meets your company's interpretation of the rules.

Q. What should companies look for in a robust ERLM application and supplier?

A. A robust application will include a flexible revenue management rule configuration tool that can be used to meet your company's interpretation of the rules today and allow for future changes. The configuration rules need to allow the ability to incorporate contract terms and conditions that affect revenue management. The system needs to be secure and auditable. Complete tracking of the configuration rules, including an audit trail of changes, is a requirement. Of course, a complete audit trail of each transaction, including any changes or adjustments, is also needed. The ERLM application should also include an open API strategy because integration to other systems, such as CRM and ERP, is a necessity.

The best suppliers of any application product employ industry experts and focus on the quality and functionality of the products. Be sure you understand the product road map, delivery schedule, and track record of delivering on the road map. Take the time to talk to referenceable customers with businesses of similar size and complexity in the same industry. Talk to these references about implementation, how the system is being used and supported, availability of a knowledge base of training, documentation, and community engagement with other customers and resources. Finally, make sure the supplier is actively engaged with industry associations and the accounting profession so that it is prepared to deal with future changes to revenue management guidelines. The supplier should also provide thought leadership materials and training to demonstrate that it is engaged in and staying on top of regulatory changes.

ABOUT THIS ANALYST

Christine Dover is research director of the Enterprise Applications and Digital Commerce program for IDC's Software Business Solutions Group. Christine provides insight and analysis into enterprise applications software vendors' product portfolios, go-to-market strategies, and ecosystems. She also provides qualitative and quantitative market sizing and research on enterprise applications and digital commerce.

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