

## Case Study Klopotek Software Implementation: PPM Royalty Write-Off



Thomas Pichler, CFO, and Jörg Warmer, CIO, were responsible for the roll-out of Klopotek software for Verlagsgruppe Random House. In an interview with us, they explained why the Royalty module in the Product Planning and Management system (PPM) represents a sub-ledger, why, along with royalty statements, write-offs are of significant importance to a publishing company – and how the collaborative project between Verlagsgruppe Random House, Klopotek and arvato systems achieved a change of philosophy “from write-offs to value creation” (Thomas Pichler).

### “From write-offs to value creation”

? Can you begin by telling us the reasons for extending the Product Planning and Management system at Verlagsgruppe Random House – and why you decided that you wanted to carry out royalty statements in PPM?

**Thomas:** The Klopotek PPM system has been in use at Verlagsgruppe Random House since 1994. All of our contracts, products and business partners were contained in the system, but royalty statements were still taking place outside of the Klopotek system. Changing this became more and more important, because the interface to our previous system entailed considerable additional expenditure: all the information from PPM had to be re-entered via a manual interface. As the old system was to be replaced, a roll-out was planned which, as of 2004, was intended to process the royalty statements for Verlagsgruppe Random House with Klopotek’s software. The royalty write-off component was conceived almost in parallel to this project. There are a number of capable systems for royalty statements on the market.



“The important thing is that all the information is available immediately in order to make further decisions.” (Jörg Warmer, right, pictured with Thomas Pichler)

## VERLAGSGRUPPE RANDOM HOUSE



Headquartered in Munich, Neumarkter Strasse 28: currently 45 imprints are part of Verlagsgruppe Random House.

Verlagsgruppe Random House grew out of the venerable C. Bertelsmann Verlag, which was founded in Gütersloh in 1835. Verlagsgruppe Random House currently includes 45 imprints which produce fiction, books for children and young adults, reference and theological books, guidebooks, audio books and e-books. Among these imprints are, of course, C. Bertelsmann, along with Goldmann, Heyne, Blessing, Blanvalet, Knaus, Luchterhand, Siedler, btb, Manesse, DVA, the Gütersloher Verlagshaus, Gerth Medien and many more.

### Project Focus

Product Planning and Management system (PPM): Royalty Write-off, Royalty Statement

### Timeframe

Klopotek PPM since 1994; additional PPM components for royalty statements and write-offs since 2004

### Project Location

Munich

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"For a big publisher that's part of our group, we need about 1 to 1.5 hours. [...] We carry out an individual write-off, but – and this is the key point – it is a system-supported individual write-off. We look at the 20% which have a significant influence on the write-off; but 80% pass through the system automatically according to defined rules." (Thomas Pichler)

We are well aware of the range of products out there. However, the problem with software products is that frequently royalty statements are not coordinated with the general ledger. This can – one has to say – lead to grave consequences. Because at some stage the systems have to be reconciled with

demands must be made of the quality. In our case, the system even became subject to auditor approval. That's why we got them involved in the project phase.

**Thomas:** In addition, the area of royalties has a large external dimension for us as a

“ When you elevate a system such as PPM to the status of sub-ledger, then very specific demands must be made of the quality.

Jörg Warmer

one another, and this can result in major correction expenses. That's why we decided right from the start that we would only extend the use of PPM into the royalty statement area if there was a sub-ledger function in the system – if it was so interlocked with the general ledger that differences did not occur at any point in time. Of course, you have to look at an error log from time to time, but in principal, the general ledger and the sub-ledger are always reconciled in PPM.

**Jörg:** When you elevate a system such as PPM to the status of sub-ledger, then very specific

company. So it was also very important for us to have a certificate from a major auditing firm in the hand – at that time it was KPMG – in order to prove to our licensors that our system calculates correctly.

? The royalty statement roll-out – including what you required of Klopotek with regard to the accounting processes – was not the last step though...

**Thomas:** During this project phase, we quickly came to the following consideration: Now

that we can calculate which royalties are due for which titles with Klopotek, we would like to be able to create a reliable forecast on this basis. Because, up till then, the amount of time that we had needed to invest with the people responsible for sales and the program was disproportionate and meant that you lost sight of the important things.

? Why is royalty write-off such a relevant process?

**Thomas:** Royalty advance payments represent one of the biggest assets in the financial statement of a trade publisher. In our publishing environment, the settlement model with our authors functions largely via guarantee payments which are transacted as advance payments. The publisher takes the risk and has to make write-offs if the title sells below expectations. This process has to be managed and this means, above all, it should remain constantly transparent. This is true from the moment the contract is signed, during publication and until the end of availability. The development of a title should be presented transparently and continuously and be accessible by all parties at any time.

? You are subject to very strict evaluation requirements, in particular due to the conversion to IFRS [International Financial Reporting Standards].

**Thomas:** That's right. Because of these stricter evaluation requirements, we are compelled to carry out individual write-offs – it is not possible for us to work with flat rates or similar tools. Each individual title must be valued. In order to optimize our operating processes in this area, our requirement of Klopotek was, from the beginning, that 80% of the titles were calculated system-side without manual intervention being necessary. This only works with a sophisticated methodology, which has to be mapped into the system. For this, we defined several phases for a title – from before its publication through development on the market to an attractive backlist phase. Different methods of calculation were stored for each phase. IFRS requires this kind of methodology – that I value a title differently when it is published as when it is not yet published, and so on.

? How did the requirement arise that 80% of the titles had to be written off without being looked over again?

**Thomas:** The bulk of the titles have very little influence on the extent of the write-off. In our experience, 80% of the titles only compose 20% of the write-off. Conversely, this means that 20% of the titles compose 80% of the write-off, and the plausibility of these titles is then reviewed with those responsible for sales and program management. Of course, PPM also creates a prognosis for these titles, and it is good too, but a system cannot cover in detail which activities positively influence and promote the development of a particular title.

? Particular developments which – even weeks after its publication – make a book a bestseller cannot be captured for calculation, by anyone...

**Jörg:** That's true. However, what a system can and must do is correctly analyze the statistical sales information which is available in the publishing house and derive the right rules from it. We collected the statistical experience – Klopotek's task was to carry this over correctly and to precisely display the phases and curves behind it.

Of course, the rules which are stored change – because the market and the surrounding conditions continue to develop. Therefore, it was also necessary that we could fine-tune the Klopotek system without a lot of effort – with manageable means – every year.

? Perhaps you could give us a simple example of these rules?

**Thomas:** A fiction book, for example, develops differently than a non-fiction book. In fiction, a title usually goes up very quickly, but also comes down again more quickly. A non-fiction book normally has a more restrained start, but goes much longer. So the sales curves are calculated according to genre in the novelty phase. In the backlist phase, by contrast, this difference no longer plays a role. You determine the average for the last few months and continue to record these sales on a diminishing scale into the

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future. “You” is, of course, the Klopotek system which turns our information into calculations.

**Jörg:** We can draw upon a wealth of experience and information in this area in order to sort titles into groups and phases. And we re-evaluate this information every year, for instance, whether the development has changed in a particular title group. However, it gets really interesting where there are deviations.

? How does it become noticeable if a title deviates from the expected course?

**Thomas:** This tends to happen when it becomes relevant for royalty write-off – that is, when it joins the 20% that I mentioned

before. We look at those titles which exceed a certain level of write-off – if a title sells well, it generally isn't relevant in this situation.

**Jörg:** It was important to us to reduce the volume that we have to deal with internally to that which is important in a particular context. And that's what happened for write-offs with PPM.

? How long do you need now – with PPM – for a write-off conference?

**Thomas:** We carry out write-offs in line with the IFRS twice a year – together with those responsible for sales and program – where we examine the 20% already mentioned. For a big publisher that's part of our group, we need about 1 to 1.5 hours.

“Of course, the rules which are stored change – because the market and the surrounding conditions continue to develop. Therefore, it was also necessary that we could fine-tune the Klopotek system without a lot of effort – with manageable means – every year.” (Jörg Warmer)



This is absolutely manageable. And it is an expression of the philosophical changes we have implemented.

? Can you elaborate on this change in philosophy?

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Thomas Pichler

**Thomas:** Through this project with Klopotek, we made the step from write-off to value creation. Our top priority was to remove the negative connotation from write-offs, because in this process, you look per se at the titles which are performing worse than expected. To derive something from this, you have to achieve two things: that those responsible can concentrate on what is im-

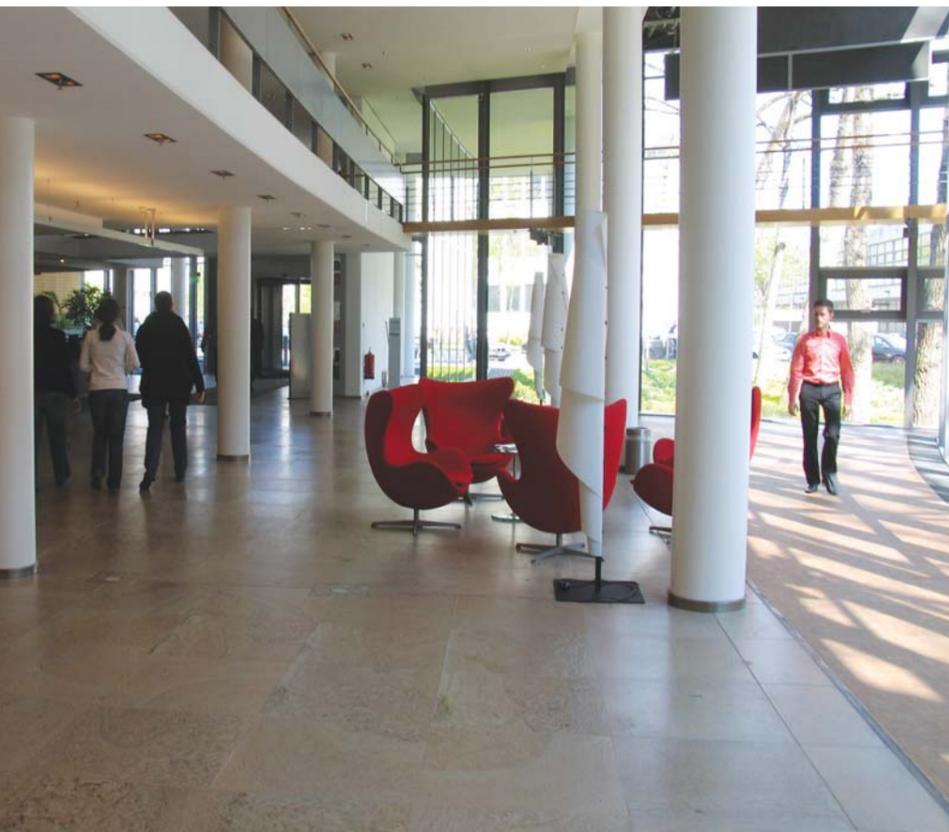
portant, and that you achieve the transparency which is required to make the necessary decisions.

That's why one of our requirements of Klopotek was to be able to see the titles that are part of the royalty on sales and sales projection immediately with a double-click.

And that when something is unclear, you can get the underlying information on the title with another double-click. The fact that all the data in the system is interlinked enables the transparency that we need.

? How does this transparency which you're talking about manifest itself?

The entrance hall of the Munich headquarters. Further Verlagsgruppe Random House operations are located in: Gütersloh (Gütersloher Verlagshaus), Asslar near Frankfurt am Main (Gerth Medien) and Cologne (Random House Audio). Verlagsgruppe Random House employs roughly 800 people.



**Thomas:** Write-offs have become a mirror which we hold up to ourselves twice a year. You see very clearly: what you planned, what developed better and – among other things – where you are below expectations. Then those responsible for program management and marketing can selectively consider where and to what extent things can be reworked.

**Jörg:** The important thing is that all the information is available immediately in order to make further decisions.

? So standardization and automatization were important elements in making these meetings so effective?

**Thomas:** Exactly. We carry out an individual write-off, but – and this is the key point – it is a system-supported individual write-off. 100% of the titles are calculated with PPM, we then look at the 20% which have a significant influence on the write-off; but 80% pass through the system automatically according to defined rules.

? Can you put a figure on the time savings you have achieved?

**Thomas:** As I said at the outset, we are talking about the major assets in a trade publisher's financial statement – these have to be managed. And the necessary transparency can be created with PPM. The time savings only play a minor role. The end result counts, and that is that we have increased the recoupment rate and were able to significantly reduce the impairment ratio.

? So you could say it was success through technology-supported reassessment?

**Jörg:** Yes, this is the change management component in this process. With PPM, you can, of course, if you cling to a negative view of write-offs, just continue working the same way as before. The tool does not take away the need to rethink and reassess: it is important to recognize within the company that there are also opportunities connected with the write-off process, that you tell yourself, if I have to make this my business anyway, then I should make the best of it.



We collected the statistical experience – Klopotek's task was to carry this over correctly and to precisely display the phases and curves behind it. (Jörg Warmer) Petra Steinfeld, Director at Klopotek, pictured talking to Thomas Pichler and Jörg Warmer.

? Up till now, we have been talking about royalty write-offs. But what about stock corrections?

**Thomas:** We use the PPM system to determine the prognosis, whereby the methodology is modeled on the royalty calculation. This data is then transferred to our SAP finance system where stock valuation takes place, but the advance planning happens in PPM.

? The system's fast-close ability was another of your requirements.

**Thomas:** This is another important subject for people in Finance. In many publishing houses, the 31st of December has gone by and you still have no idea how the year went, because the important factors – stock and royalty valuation – are still a kind of black box. We were able to change this by not doing the evaluation on the 31st of December, but 2 months before the last trading

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day. October is the basis for the annual statements in December, and April is the basis for the mid-year reports. Despite a high level of accuracy, a little fuzziness may appear for an individual title with this method, but this difference is unimportant for the overall picture. And we have achieved our goal of not having to experience any surprises. Another positive effect is that we can create the annual statements more quickly. Of course, with this procedure, we are only talking about the valuation. In PPM, the royalty statements and royalties that are due are determined exactly as at the 31st of December. Because the Klopotek system offers the sub-

ledger function, we don't have to work with reserves in this area like other publishers. The sales royalties that we determine as at the 31st of December are immediately offset against advance payments or paid out.

? Verlagsgruppe Random House can now look back on several years of royalty write-off with the Klopotek system. In your view, what has made the project an enduring success – who contributed what?

**Thomas:** We applied the knowledge of the write-off process that we have gained over

numerous years. We knew what we wanted from the system – and what we didn't want.

**Jörg:** arvato systems had the technical know-how about our available systems. We had to create interfaces to the SAP finance system and the distribution system. Our associates at arvato also took over the management of the project.

**Thomas:** Klopotek were the ones who listened to us systematically and recorded the specifications that we needed in the system. And Klopotek were always analyzing and questioning: "Does this make sense here? – Is this the best way?" They had outstanding employees and programmers who were committed to following our line of thought – from the commercial side as well. The workshops which we ran together

were of a very high standard, and this was important, because write-offs are not a trivial topic.

**Jörg:** Of course, as with any project of this size, there were highs and lows. But that is just a part of such projects. When there were problems, we always quickly pulled it together again and planned the next steps in a solution-oriented fashion. In this way, we made the project a success.

? Would you recommend that other publishers employ Klopotek's write-off component?

**Thomas:** If you are already using PPM with the royalty statement component, then, in my view, it is difficult to understand why a company wouldn't use the write-off component to create the necessary transparency in this important area as well – and, in this way, draw positive lessons from the process, and not just for the commercial areas of the company.

“ We have increased the recoupment rate and were able to significantly reduce the impairment ratio.

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**Jörg:** We think it's important to drag the royalty write-off process out into the open. Then, supported by a system which offers an exact mirror of the development, you can draw something positive from it. In any case, we are very pleased that we did.

**Thomas:** Since then, the write-off conferences have become an integral part of our work. Our publishers also have the write-off system at their workplaces and can access up-to-date information on their titles any time they want.

## Features of the Royalty Write-Off component of Klopotek's PPM

This system-supported write-off determines the amount that has to be written off because the guarantee that has been paid will most likely not be used up when offset against the accumulated or projected royalty.

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The following business and fiscal factors affect the royalty write-off in Klopotek:

- **The contractual royalty**  
Is taken into account for internal controlling and reporting purposes.
- **The contractual and fiscal royalty**  
Is taken into account for external invoicing and tax calculation.

The royalty write-off component includes of the following features:

- **Projected sales batch procedure**  
Determines the number of copies subject to royalties that are used for royalty projections.
- **Royalty write off batch procedure**  
Prepares data for the royalty write-off and automatically performs a royalty write-off; determination of the adjusted balance which has not been written off.
- **Royalty write off application**  
Reviews the data of the automatic royalty write-off by the user; manual modification

of the parameters and values at the title and rights level; quick calculation following manual changes.

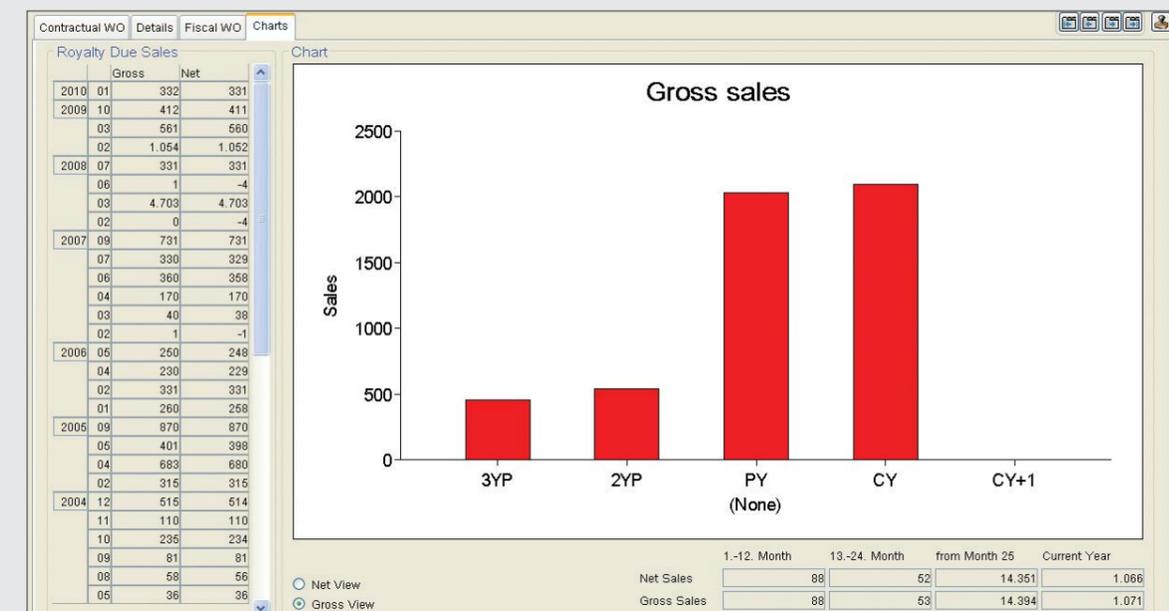
- **Standard interface**  
For the export of the royalty write-off to the financial accounts and cost statements.
- **Write-up**  
To change or cancel royalty write-offs that have already been performed to reflect alterations in the sales situation.
- **Reports**  
For monitoring and evaluating the results of the royalty write-off.

Contractual WO		Details		Fiscal WO		Charts	
Company Gr.	The Academic Publ.	Title	978-0-3333-9723-7	Bones, The Medical Journey	Total Stock	219.818	
Title Segment	The Academic Publ.	SubjectGroup	Haematology	Price	6,99 £	1. Wahl Stock on waiting invoice: 8.015	
Delivery Status	Available	First Release	11.04.1996	Planned	01.03.1996	1. Wahl Available Stock 211.765	
Total Sales	14.635	Pending Orders	20	Date	0	1. Wahl PeriodicallyResStockINV 35	
						2. Wahl Remainder 2nd class 3	

Royalty Due Sales		Corrections						
Gross	Net	Eff. Date	Qty	Manual	Notes	Royalty Qty	Manual	Notes
2010 01	332	331						
2009 12	0	0						
11	0	0						
10	412	411						
09	0	0						
08	0	0						
07	0	0						
06	0	0						

An example for write-off information displayed on title level. Royalty write-off utilizing Klopotek's PPM can be handled from a business and from a fiscal perspective.



Graphical information on the performance of a title helps users make quick decisions on suggestions made by PPM regarding the amount of money that should be written off. At Verlagsgruppe Random House, 80% of the titles pass through the write-off process (conference) according to defined rules without manual intervention being necessary.

Our publishers decide which books are published. We on the business side, along with the IT department and the Klopotek system, deliver the best possible support for the decision-making process.

Of course, technology can only play a supporting role, but – as we were able to learn – this role can be substantial. Thomas, Jörg, thank you for the interesting interview and for the insights you have granted us. ■

Verlagsgruppe Random House publishers cover a broad spectrum of "high-quality writing from classic and modern literature, books for children and young adults, guidebooks, self-help titles, and religion to a program of reference books which spans a wide range of subjects and themes." (Source: [www.randomhouse.de](http://www.randomhouse.de))



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Thomas Pichler



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