

THE COLLECTION PROCESS FOR SULAKE CORPORATIONS

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Case company report for the course:

Data mining and data warehousing

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Company background

Sulake Oy is an internet game development company based in Helsinki, Finland. It was founded by Sampo Karjalainen and Aapo Kyrölä in 2000. The main shareholders in Sulake (as for November 2006) include Taivas Group, 3i Group plc, Elisa Group, Benchmark Capital and Modiva Group, as well as the company's founders, and other personnel. Moreover, Habbo Hotel has been granted funding from the Tekes Technology Programme FENIX - Interactive Computing. (source: Tekes website) The company is currently employing 290 people in 19 countries.

It all started with an amateur project in autumn 1999, when we created the Mobiles Disco web site for the Mobiles band. In Disco, pixelated characters created by the games users allowed them to meet and talk', says the Manager of Game Development Sampo Karjalainen (source: Tekes website). Mobiles Disco proved to be so successful that Karjalainen and Aapo Kyrölä decided to try to turn their idea into a business. Under the guidance of the advertising agency Taivas, they started to develop Hotel Goldfish, which is now known as Habbo Hotel.

Sulake's main product is the [Habbo Hotel](#) – online community and virtual world, used by over 66 million registered users in 29 localized services. The Hotel attracts more than 7.1 million visitors per month. Habbo Hotel is an online game world designed for young people and has become one of the most popular and fastest growing teen websites in the world. In this virtual Hotel multiple users can play simultaneously. The users create virtual Playmobil-like figures to represent themselves. The characters, or avatars, can move around within the hotel and meet other players for discussion. All users can play a wide range of games available on the Hotel site, connect with their friends, decorate their rooms, dance by the pool etc.

The Habbo brand has been extended already to mobile games, as well as to real-life merchandising products, such as T-shirts. Habbo's animation series are planned to appear on television and they are meant to attract new target audience. Most of the business Sulake generates comes from the sale of virtual furniture, pets, TVs, or Christmas' gifts,

food and special party arrangements. The Habbo Hotels users pay with real money for virtual coins that they can use to purchase different things. As the Habbo Hotel case shows, there are plenty of young people around the world willing to spend real money on virtual widgets, post-it notes or chairs. Because most of the hotel's users are minors, the company had to carefully consider a business model that would not take too much money from the kids, like for example setting a maximum weekly limit for mobile charges.

The company's founder Mr. Karjalainen states that:

'The message we want to communicate to parents is that it is okay to pay something to play games online if in return the user gets good and meaningful entertainment' (source: Tekes website)

Payment modes depend on what kind of electronic and offline payment systems are available in the country where the user lives, such as money orders, billing to the phone, checks, cash through the mail and credit cards. It has built-in limits to make parents more comfortable with the scheme (source: Benchmark website). Sulake has 150+ external payment partners all over the world. In Scandinavia, Sulake's main billing partner is Ericsson.

Connecting to Ericsson's IPX (Internet Payment eXchange) platform allows Sulake to commercialize its content, regardless of which operator their customers use. Users can conveniently pay for a wide range of premium services via their regular mobile phone bill or prepaid subscription.

Ken Le Drew, eCommerce Director, Sulake Corporation Oy, says: "We are pleased to partner with Ericsson. They offer a very robust and secure mobile payment channel for Sulake. We like their track record. In addition to Norway, Denmark and Sweden, Sulake is already working with Ericsson IPX in Singapore and Portugal and we will also soon launch the IPX solution in Malaysia. Ericsson is a key payment and distribution partner for Sulake, given its platform stability and online-billing availability".

Ericsson IPX is available to more than 650 million mobile subscribers in 21 countries, with new markets being added monthly. Ericsson IPX is a non-branded, white-label service that comprises billing and mobile connectivity via SMS, MMS, Web and WAP (source: Ericsson website). Sulake faces strong competition from other similar sites. Some of them are presented below.

Faketown – <http://www.faketown.com/home.php> (California-based Faketown is a 6-year old “social game”. The site centers around a virtual chat room, and allows users to create, buy, sell, trade and share virtual products, services and real estate - it’s broadly similar to Habbo Hotel, Cyworld and Gaia Online, but with a freedom to develop your own content).

Gaia Online – <http://gaiaonline.com> (California-based Gaia Online is a forum and a role-playing game. Users have their own customizable avatars and earn virtual money (“Gaia Gold”) for every action on the site. The currency can then be used to buy clothes and accessories for your avatar, or to play Flash-based games. Gaia Gold can’t be bought directly with real money, but users can make a donation to the site and receive a surprise gift in return. Gaia also includes a virtual world called “Gaia Towns” - 3D chat room that is very similar to Habbo Hotel).

MySpace – <http://www.myspace.com> (Social networking website created in 2003 by Tom Anderson in Santa Monica, USA)

Cyworld – <http://cyworld.nate.com/main2/index.htm> (South Korea's most popular social network. Cyworld’s revenue comes from the sale of virtual items. Its U.S version was launched in August 2006).

Second Life – <http://secondlife.com> (Site is similar to Habbo Hotel but targeted at an older market segment, meaning adults. It is provided by San Francisco based company - Linden Labs). (source: Mashable website)

Sulake's strategy

This section provides a schematic, and oversimplified, description of the different phases of Sulake's lifecycle and the nature of the issues involved in each. During the start-up phase the issue was to provide entertainment and gain fame, i.e. one wanted to see whether or not people were interested in the offering. It was only with the involvement of the marketing bureau Taivas that the commercial potential of Habbo began to be explored.

The next phase, and the concomitant question, was which kinds of payment methods could be accepted. The company arrived at a very broad solution, in that it was once again a question of seeing whether or not a payment method was feasible. The emphasis at this stage was not so much on the profitability of the payment method, but whether or not it worked. In the next phase, the company started looking at ways of calculating the profitability of payment methods treating these as individual products with a defined cost-structure. Relating to this, the most critical success factor would be to offer the right kind of "product" to the customer, i.e. there are big cultural differences regarding which payments work in which target group. This way of conceptualizing payment methods needs to be elaborated.

Suppose you were running a traditional manufacturing business, i.e. all of the basic supply chain philosophies were easily applicable in your case. One of the most basic, and thus important things you need to have a handle on is the distribution of your product. This is a non-trivial affair for a traditional manufacturing company, as is easily understood by perusing a textbook on the subject. Also, in this case the collection process is, if not trivial, then at least not the most riveting process in the pallet of available processes that a company such as this might have.

However, in Sulake's case it is quite the opposite. First, finding a way to distribute your product is not an issue, at least not in the same sense as that of distributing something tangible would be. Second, given the schematic view of the company's history outlined above, collecting micro-payments in a highly differentiated payments environment is quite a challenge. Not only do you need to collect, monetarily speaking, small streams of

cash, you also need to do it profitably, i.e. with a view to your profit margin. So, in this sense, one can look at the collection process as a kind of inverse distribution chain, where the real issue is in collecting the payment not on distributing the product. To be able to grasp this problematic, it is most viable to view each payment method as a product and apply profitability measures to them as you would to any tangible product in a traditional company.

Getting back to our schematic overview, what has been characteristic of Sulake's strategy in calculating the profitability of each payment method is the use of standard profit and loss measures. It is important to realize that as the company has been the target of large infusions of cash, and a possible public listing in the future, more emphasis needs to be put on cash-flow performance measures, i.e. at what the shareholder gets. This is the phase Sulake is in now, i.e. applying financial performance measures that reflect the position of cash flow such as **Days Sales Outstanding** to the payment methods. We also need to realize that a broadening of those monies to be collected, from invoiced money in accrued revenue to all money outstanding, should be enacted. There is also an ongoing process that would seek to increase the specificity in the contract terms between the corporation and its subsidiaries.

We would like to know about the structure of the company in general, and the inverted distribution chain in particular? This should give us an idea of how the collection process works, in a physical sense, and what the main control issues are as relates to the process.

To this end we need to chart all of the intermediate levels between the end user and Sulake. We also need to understand that the physical process, and the information gathering involved, not only varies by payment method but also by partner. Accordingly, control issues vary depending on the partner involved and the payment method adhered to.

Payment methods: Control and associated issues

Sulake is a corporation with a number of subsidiaries around the world of varying sizes. There are also other external partners involved between Sulake and the end customer that need to be taken into account. Generally there exists the following split between billing partners; telecom, on-line and off-line. This three-way split also reflects the different payment methods, which include: telecom payments (SMS and IVR), credit card payments and prepaid cards (this list not being exhaustive).

The main control issue in each of the payment methods is to make sure that the partner pays according to agreed terms. The main accounting issue is when to recognize revenue.¹ Taking each of the included payments in turn, what are the different characteristics of the collection process? And how can you solve the control and associated issues for each payment method?

Telecom payments

For telecom payments Sulake does not have deals directly with operators but through an aggregator. This means that there are, in essence, four entities involved in the telecom payments process; i.e. Sulake, an aggregator, an operator and the end-user. The main control issue here is to compare the transaction volume to housekeeping. To explain, Sulake has its own internal transaction log that keeps track of how much users spend in the Hotel. When the telecoms billing partner, i.e. the aggregator, sends their monthly payments report the controller can check whether the transaction volumes match, if they do payout levels should be checked.²

Another issue is fixing a valid due date for telecom sales, which has a lot to do with the corporate structure of the company. The time it takes for the operator to collect from end users and pay the aggregator varies with the market in question. Thus, the aggregator can blame the operator when payments are slow.

¹ There is also the additional question of who should be able to recognize revenue from the provision of content. Since revenue arises from the expected benefits of ordinary activities, we need only ask whose ordinary activity it is to produce content on the web (Epstein & Mirza 2004, 241-242).

² See also appendix 2 at the end of this report for a visual diagram.

Credit cards

End-users can of course also pay using credit cards, in this case the control issues are complicated by the fact that no monthly statement, or report, is issued by the billing partner. Instead the money is paid bi-weekly net of expenses, which in turn can vary according to billing partner and the agreed upon terms. Also, Sulake has to compile various monthly statistics and reports collected from the partners extranet to be able to establish sales for a certain month.

Prepaid cards

With prepaid or scratch cards Sulake provides the billing partner with cards. The billing partner reports amounts sold on a monthly basis. The control issue here is when to recognize revenue. There are two basic options; 1) the traditional option of recognizing revenue when the invoice is sent for the cards to the billing partner, or 2) recognize revenue once the billing partners report arrives. Sulake has opted for the latter choice. There is however another accounting issue involved, and that is whether or not to treat delivered but unsold cards as inventory, Sulake has not done this so far.

Special issue; recording transactions in time and revenue recognition

The recording of transactions takes place in housekeeping. However, the recording of transactions in time varies from payment method to payment method. Control, profitability analysis and revenue recognition are all affected by this issue. As this detail has an important bearing on all of the major issues in this paper it is motivated to treat is separately.

For, example an SMS transaction is recorded when the SMS code is sent to the operator. This is the case because an assumption is made that the end user physically uses the code immediately. In the case of prepaid cards the transaction is recorded when the end user redeems the virtual coins by entering the code. It is assumed that the user will use the coins immediately to execute a transaction.

This difference underlines the fact that clear business rules need to be set for when a transaction is recorded in time. Otherwise control and other issues are aggravated further. So the system needs to be set up in such a way that the partners and the corporation record transactions generated at the same point in time.

Payments Method Report: the backbone of the collections process

Each month Sulake receives a so-called payment report from its subsidiaries. The payment report consists of a list of different payment methods; each payment method is treated as a product with a defined cost structure. The report also includes information about currencies, information from housekeeping concerning transaction volumes and so on. At this point it is important to bear in mind the definition of a transaction, because whilst the operator might refer to a transaction in terms of minutes the partner might refer to these as unit of calls. There is also an entry for gross revenue; this is then used to calculate the cost of sales in absolute terms. The entry for cost of sales consists in the gross revenue from the payment method net of commission, withholding tax, refunds, charge backs, handling fee, transaction-based fee, bad debits- e.g. for those instances where the end-user does not pay the operator.

One central idea of the payments methods report is the enablement of profitability analysis. This is achieved by calculating the relative cost of sales, i.e. COS%. This measure is calculated as cost of sales through gross revenue. The idea with this relative measure, as with any such measure, is to be able to compare the different “products” amongst each other.

The other central thing about the payments method report is the calculation of revenue for a given month. The problem arises from the fact that even if you do not have a report available for a given month you still need to calculate sales for that month according to the sales of that traffic month. This information is critical in the sense that it is used to calculate the official turnover. There is then a typical workflow structure that is determined by the existence/ non-existence of the payments report. First, in those cases where no statement is received you have to estimate sales from the transaction volumes in

housekeeping. Second, when the report arrives no estimates are needed. Third, when the statements for previous months arrive and the estimates need to be corrected for possible variances.

Example of profitability template

The payment methods report is usually done in excel. Moreover, it is usually the case that the country manager in charge of making this report has no financial background. Nevertheless, as this example aims to show these reports can function as a template for the communication of business ideas. The country manager in question had found a way of categorizing the different payment methods according to their phase of completion by color coding the excel spreadsheet.

The payment methods were categorized according to 1) cash not received (from e.g. operator) not paid (to Sulake), 2) cash received and cash paid, 3) cash received not paid. The obvious point would be that by using these modal modifications of the status of cash, you could arrive at a more sophisticated analysis of your “products”. In a sense you could, at least in principle, devise a model for the temporal dimension of the collection process.

However, there is also a more important, yet not as obvious dimension to this template. It was pointed out to us that the third possibility, i.e. cash received not paid, should not be a possibility at all. This is so because payment terms, in the general sense of the time a customer can take to pay a service provider is not applicable to billing partners. They should pay Sulake immediately upon receipt from the operator.

Current Information Systems and Future Plans of Integration

Sulake uses different applications for the different demands of the collections process. Some have already been mentioned, such as excel while others like Basware business planning, the internal transactions log also referred to as housekeeping, iScala invoicing also exist. Sulake also has an ongoing data warehouse project with MySql and Business objects chosen as the tools. Sulake uses a number of formal and informal communications channels such as phone, e-mail, aim, msn messenger, Skype, breeze and

QPR's management information system (WOW portal). Also one should consider excel and Basware business planning as communication portals.

In the following we will discuss the shortcomings of excel and try to see what control goals could be attained by getting the payments method's report into Basware business planning in some cases and into iScala in others. The shortcomings of excel are perhaps the lack of proper control functions. There is simply too much room for mistakes, and while you can "protect" certain elements in an excel spreadsheet, there are still ways one can tweak it in one's favour. Also, in this case as country managers usually have no accounting or finance background, this only serves to aggravate the problems. There are no automatic controls to make sure that cost per payment method is correct, that nothing is missing, and that estimated data is corrected according to a partner's final statement. Taking these in turn we have a desire to include goals for input accuracy, input completeness and update accuracy.

Automating certain elements in the payment report would go a long way in providing for desirable control goals. One should be able to allow for templates, like the one above, to be shared among the users of the system, at least concerning reporting purposes. The report template described above is a model of the corporation and the actors within it, simply by looking at the report and hearing what HQ had to say about the third category we could tell that they have differing conceptions of the way the collection process should be handled. This also leads to the conclusion that payment terms from the different contracts need to be modelled into the system.

Another thing would be to import transaction volumes and sales from housekeeping into the payment method reporting system. Housekeeping does not include information about costs, if this could somehow be imported into the payment method report then this would save the country managers' time and make the controls of transaction volumes safer. This would also ensure that the cost per payment method is correct, as the system would calculate the volumes net of commissions and so on. This automation would thus secure input accuracy and provide for the efficient use of resources.

Sulake's current approach to billing

It is critical to Sulake to improve the control of payment methods from the financial point of view. The collection process varies depending on the payment method used. Different countries have diverse payment methods, one reason is the varying age brackets of target groups, e.g. the Asian target group is for ages over 20 while the Sulake's European target group is for teenagers, i.e. between the ages of 12 and 18. Also, different payment methods receive different degrees of acceptance in distinct cultural spheres. From the commission and cash flow point of view, in order to achieve better revenue, it is desirable for Sulake to seek to optimize the various payment methods because of the different commissions involved.

SMS

The two basic aspects concerning the billing partners are to find new partners and reevaluate existing billing partners. The criteria for finding new partners includes the technical integration of the applications used and credit checks; also one needs to evaluate the profitability of billing partners. As was mentioned above, Sulake uses different applications for the different aspects of the collections process e.g. revenue recognition, control and profitability analysis. It is therefore necessary to make sure that potential new partners and Sulake can achieve the desired level of technical integration, which will lead to time and cost savings. Sulake used so called billing partners contract templates in the start up-phase and thus did not proactively draw the contracts themselves. This had some impact on the use of credit checks which were not done on a regular basis in conjunction with drawing up contracts in the beginning. This situation has been amended and Sulake does make regular credit checks on all existing partners.

General remarks

Sulake also uses incentives for using more profitable payment methods in some countries. For instance an end-user who utilizes a certain payment method may pay less than if using another method. Sulake also utilizes campaigns to this end, hoping that once users become acquainted with the method they will use it in the future. Also, incentives are offered to those who purchase a larger amount of credits at a time.

Too many payment methods, especially unprofitable ones, may not be justifiable in the long run. However, as long as the end-user segments are so varied all payment methods are currently needed. New ones may also be added, like PayPal or similar methods.

Our suggestions for improvement

Suggestion on control issues

A two-way transaction system would be optimal, where Sulake is the one that releases “activation codes” centrally for all Habbo Coins and items that can be redeemed, no matter what the payment method or from which country the request comes from. For each SMS, IVR phone call, prepaid voucher, credit card payment and bank transfer Sulake would be the one that supplies the user with an activation code that can be redeemed for a specified amount of coins/items. This system would enable Sulake to tie each activation code to a unique transaction and in that way get actual sales data on transactions. The negative aspect of this is of course the infrastructure cost of implementation, it might not be financially feasible to implement something like this but it could be worthy of further investigation. Another control issue raised in above section is telecom payment control. How to control aggregators and partners?

Sulake has reserved the right to audit the aggregators, but this makes little sense without auditing the operator as well. One way to control aggregators would be to have the operators send a collection statement to Sulake corporate at the same time they send one to the aggregator in question. The operator can only be controlled by the information in the Hotel about virtual money activated via the operator channel. This way Sulake can calculate how much is outstanding and still to be collected. How promptly the payment is made is more a question of bargaining power than technical implementation of controls.

Sulake should consider reducing the number of different aggregators and try to find service partners that cover larger areas and offer more complete service to cut down transaction cost and to follow up on payments. The decision to choose Eriksson’s IPX service for the whole of Scandinavia is a step in the right direction. This also opens up the

possibility to strengthen the tie between actual transactions and billed transactions, meaning faster payment and added revenue. With Sulake's rapid growth they have gained stronger negotiation power compared to when they were a marginal player entering the business.

Suggestion on Credit card payment

Regarding credit card payments, a global partner (like PayPal or WorldPay) could be considered. The cost of having separate contracts with the acquirers around the world is relatively expensive when considering the volume of transactions that is made by credit cards. This single partner would also handle the technical side of the payments like chargeback's and possible refunds while offering 24/7 customer service on all matters regarding payments. One would also think that a lower commission fee would come as a result of centralizing the payment channel to one larger partner.

It is good to spare some thought on this currently marginal way of paying as the SEPA (Single European Payment Area) agreement will standardize international payment regarding debit- & credit cards. Visa Electron cards are commonly issued to minors and most issuing banks already allow international use of the cards, and this trend will no doubt grow stronger the closer we get to the year 2010 when no single country-locked cards are allowed to exist within the Economic Monetary Union in the EU. It would be in the interest of Sulake to move from having telecom payments as the most used payment method to card and bank transfers as they offer great potential for increasing Sulake's margin on the products.

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APPENDIX 1: Interview Guide

General questions:

1. How would you describe your post within the organizational structure of the company in general? What are your main tasks in relation to the payments process?
2. What kind of applications do you use?
3. What are the main issues that you faced when the company decided to expand globally?
4. Do you have global service provider partner deals (like network operators) that make multinational expansion easier?
5. Can you identify any critical success factors in conjunction with the payments process?
6. How would you categorize your partners?

Information systems and control

7. How do you communicate with your subsidiaries?
8. Can you communicate with your external partners directly?
9. Can you share information with your external partners?
10. Is there a clear audit trail for each individual customer transaction in the current setup?

11. On average, how long does it take for you to get money to your bank account after the customer has been debited?
12. Have problems with refunds and reimbursements occurred, if so are they time consuming?
13. What applications are used for creating reports by the subsidiaries?
14. Do you have in-house support & development for any custom applications you might use?
15. Is the system fast enough or is there room for improvement?
16. Do you feel that the system lacks in some important functionality?
17. Is there any batch processing done or is all information up to date and online?
18. Are there any currently paper-based tasks in this process that could be done more efficiently in electronic form?
19. Do you have problems finding information in the accounts receivable system and the information reliable?
20. Even if they are partners, and thus conceptually equal, can you think of ways of controlling your partners?
21. Do the control issues vary with the form of payment, in what ways?
22. If there are distinct control issues for distinct forms of payments, which one aggravates the control issues the most?
23. How do you create one integrated view of the data?
24. Is Sulake's information system efficient at this moment or not?
25. How does your company cope with the increasing global market from the information system perspective?
26. When is the transaction record created? Are there any problems with recording the transaction in time?

Reporting

27. Model, or describe the process in broad terms. Which activities can you identify? What are the characteristics of the activities in the process?

28. Given that your subsidiaries have varying business processes, what are the feasible ways of standardizing the processes? Which kind of strategy would you use?
29. Do you have a preferred process template that you would like to roll out in the subsidiaries? If so, what does it look like?
30. How does the fact of micro-payments, or micro-commerce, impact the modeling of your payments process?
31. Which different forms of payments exist in your system?
32. What, to your mind is the best form of payment in a micro-payments environment?
33. Does the current reporting functionality allow you to analyze which form of payment is the most profitable, i.e. with the least related costs?
34. Does the current reporting functionality allow you to analyze the profitability of your subsidiaries?
35. Does the current payments system distort, or hamper the analysis of the profitability of different segments of the market?
36. Does the current payments system distort, or hamper the pricing of products in a profitable way?
37. Does the current payments system distort, or hamper the analysis of external partner profitability?

APPENDIX 2: General Diagram of Collections Process

