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Getting Started with 80/20: Quick, Easy and Very Revealing

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When we talk to new clients about our 80/20 practice, we get a wide range of reactions: some CEOs are intrigued; some are mildly skeptical; some can't wait to get started; some think they already know everything there is to know about 80/20.

But there's one thing that's true for nearly all of the executives we meet: they haven't even taken the first step to begin the 80/20 process.

That's not because people don't "get" 80/20 or don't want to do it. By the end of our CEO seminars (which are always packed), all of the attendees are on board. They're eager to take our lessons back to the office, simplify their business, and increase profits.

Unfortunately, upon returning to the "real world," life often gets in the way. Even with the greatest 80/20 fervor, a smart business owner or executive can succumb to day-to-day pressures, a fear of change, or that old rationalizing voice that says "we're doing well enough" — and not take the first step toward significant change.

The Easiest Way to Get Started

You don't need to fire anyone or change what you're selling. You don't need to make a difficult speech to your staff or shut down an office location. You don't need to tie up your accountants for a month doing complex analyses and reports.

You just need to take a simple, quick inventory of your clients in terms of the revenues they bring to you. That's data you already have, but chances are you've never looked at it with a critical eye — or, at least, in this particular way.

Why Do a Quartile Analysis?

Put simply, once you have done it — and see what it reveals — you won't believe you've never done it before.

- A quartile analysis can be completed in just a few hours.
- The results are very easy to understand.
- You're probably going to discover something you never knew about your company.
- Finally, breaking your business into quartiles is just an analytic step — a chance to see everything with fresh eyes. It won't change your business.

Running a quartile analysis is risk-free. There's no reason not to do it. So do it now — before you lose your focus or commitment.

Divide and Conquer

Do you need special software or statistical training? No. It's this simple:

- List your customers in descending order by annual sales. The customer who provides the highest annual revenues will be at the top, and the lowest at the bottom.
- Next, divide the list into quartiles. If you have, say, 200 customers, divide the list into 4 groups of 50 each. (Put another way, the top quartile is comprised of the 25% of your customers producing your highest annual sales.)
- Now total the revenue for each quartile — and put that in the next column. Then calculate that quartile's percentage of your total revenue and put it in the third column.

You have now gone further than most people who say they believe in 80/20. And you're one step closer to simplifying your business, growing strategically, and enhancing profits.

Sit Back and Be Amazed

Take a look at the percentage of total revenue contributed by each quartile. Are the top two quartiles contributing a very high percentage of the revenue? Are the bottom two contributing a very low percentage?

Almost assuredly, yes. Chances are that the top quartile of your customers produces nearly 90% of your annual sales. The second quartile is probably far from the first but added together, the top two quartiles produce very close to 100% of revenues. The bottom two quartiles — the lower 50% of your customer base? You would hardly notice if they disappeared tomorrow. That's the 80/20 Principle at work.

What percentage of your time, cost, or effort do you think goes into supporting each quartile? It's about 25% in each, meaning that 50% of your cost is supporting very little revenue and only 25% is supporting 90% of your revenues.

Apply the Quartile Analysis to Every Part of Your Business

After you finish your quartile analysis of customer revenues, do the same thing with any products you make, the services you offer, lines that you represent and resell, and even your vendors.

So, now what? This is where the hard part starts. Perhaps, yes, your bottom customer quartiles generate almost no revenue. Maybe you haven't added a new "quartile 1" customer in a long time. You may discover that a very few of your products or services account for almost all of your sales and the rest are duds — products that you work very hard to develop, master, and support, but rarely sell.

Putting Hard-Learned Lessons to Work

It's not easy to learn that you've been investing huge amounts of time, resources, and money into losing efforts. Just remember: this tendency is not at all unusual. By default, we all suffer from this imbalance between effort and profit. Until you embrace the tough truths of 80/20 — and make a commitment to improve your business, rather than simply manage it — you and your company are bound to miss significant opportunities for profit and growth.

Unfortunately, we can't solve all the world's problems in a single article. But stay tuned in. We'll have much more to say in future articles about what you can do, and the kinds of analyses you'll need to consider before making any major changes to your business.

Your Take-Home Tip for Today: Believe The Data

Let your numbers help you formulate key questions and guide your decisions as you move down the 80/20 path. And don't go the distance alone. Experienced 80/20 consulting firms — we're one of a very few — have seen it all and can facilitate the process. Implementing 80/20 is nearly as much an art as it is a science.