

# Gillum Strategy Partners



V I E W P O I N T

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## Implementing 80/20

Capturing Outsize Value  
Utilizing 80/20 Methodology

## Cost Of Complexity & 80/20

### The Challenge:

What segmentation methodology can be utilized to reduce complexity, capture value and grow my business

The true cost of complexity is rarely fully understood across products and customers. To do so would typically take an inordinate amount of time and analysis. 80/20 is an efficient methodology to segment a business by its high and low runner products and its large and small customers, and reflect that true cost in pricing, channel, product and customer strategy.

80/20 is a proven methodology that remains still complex enough that relatively few companies pursue it and gain the full value of what it offers. But for those few, they often have operating margins 1.5X of their peers and deliver multiples of value creation in the form of stock appreciation (if public) or company value (if private) vs. the average – one example being ITW which delivered 10X the S&P from 1984 to 2019.

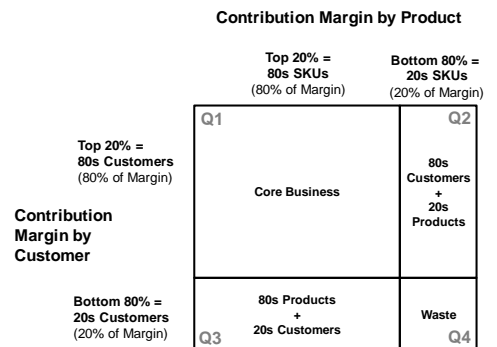
I believe 80/20 is a mostly undiscovered opportunity that all companies should take advantage of – and especially before their competition does. Companies that fully commit to mastering 80/20 become market leaders with a strong competitive moat around them.

## 80/20 Methodology

80/20 posits that roughly 80% of revenue and profits come from 20% of customers and products. If we accept this and understand the 80 and the 20 segments, we can drive greater results designing our business around these key customers and

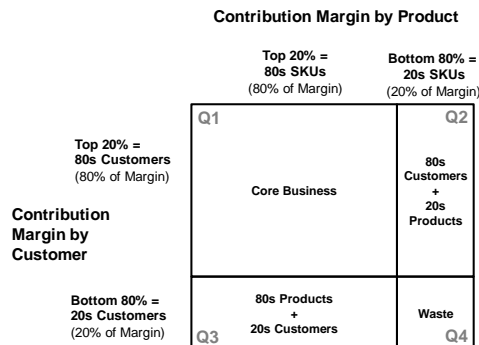
products and managing the remaining portion more effectively.

### The Quadrants



### How The Quadrants Work

To build the quadrant analysis, we capture the contribution margin of every line item sale in the trailing 12 months noting the product SKU and the customer. We then sort customers in descending order of contribution margin and segment them by the top 80% of contribution margin (large customers) and the remaining 20%. We do the same sort by product SKU in descending total contribution margin, and then segment the product SKUs into the top 80% of contribution margin and the remaining 20%. Now we know how to classify each customer (they are an 80 or a 20 customer) and how to classify every product SKU (they are an 80 or 20 product SKU). Knowing the segmentation now, we can build the quadrant analysis above.



### Quadrant 4 = Q4:

- 4% of margin (i.e. 20% x 20% = 4%)
- Smallest customers, tail SKUs
- Likely our most unprofitable segment by a long shot – consuming considerably more of our effort for 4% of our revenue
- Q4 often consumes 25% of the company SG&A for 4% of revenue – we are not getting paid enough for the product nor the customer complexity in this quadrant

## Evaluating Quadrants

### Quadrant 1 = Q1:

- 64% of margin (i.e. 80% x 80% = 64%)
- Likely our most profitable segment by a long shot

### Quadrant 2 = Q2:

- 16% of margin (i.e. 80% x 20% = 16%)
- Serving our top customers – but this segment is the tail of our SKUs – so likely very costly to support this long tail of SKUs
- Likely less profitable than Core Business

### Quadrant 3 = Q3:

- 16% of margin (i.e. 80% x 20% = 16%)
- Serving our remaining 20% of customers – so comparatively costly to serve this wide customer set, albeit with high runner SKUs
- Likely less profitable than Core Business due to higher cost to serve

## 80/20 Phases & Steps

GSP typically advocates a four step process over six months to implement 80/20.

### Step 1: Analyze Portfolio

- Gather Data
- Build Customer Product Matrix
- Characterize Business: Customers, Products, And Vendors
- Build Quadrant Analysis

### Step 2: Optimize Portfolio

- Evaluate Each Quadrant
- Develop & Quantify Potential Product & Customer Actions
- Prioritize & Select Potential Product & Customer Actions
- Build Implementation Plan For Selected Product And Customer Actions

### 80/20 Believers:

A number of years ago I asked a friend who had used 80/20 for most of his career how strongly he believed in the power of the 80/20 methodology. Without hesitation, he indicated that we was willing to get an 80/20 tattoo – and I think he meant it.

### Step 3: Simplify Business

- Evaluate:
  - Separating Value Streams
  - Inline Value Stream Flows
  - Market Rate Of Demand Systems
  - Vendor Consolidation
  - Outsourcing Where Beneficial
- Summarize Planned Actions To Achieve Simplified Business Design
- Develop Simplified Business Design Implementation Plan

### Step 4: Align Structure

- Build Bottom Up Staffing Model To Support Simplified Business Design
- Understand Staffing Changes And Economics To Support Simplified Business Design
- Develop Staffing Change Plan

beliefs on cost to serve and profitability at the customer and product level, but not proven out and made actionable until 80/20.

80/20 is one of the highest ROI projects that can be pursued. GSP would enjoy the opportunity to work with you and your team on this effort should there be interest.

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### GSP Involvement

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Gillum Strategy Partners has supported a number of businesses across a wide range of products in implementing 80/20. Typical results from these efforts have been 200-600 basis point improvements in EBITDA margins and 20-30% reductions in inventory levels.

Our approach is to work closely with clients to gather the data, conduct the analysis and make decisions on how to transform the business for outsize gain.

Client teams are struck by what the 80/20 analysis tells us – often confirming long held

**Gillum Strategy Partners** (GSP) is a boutique strategic consulting firm providing services to top tier clients in a broad base of industries, including technology, manufacturing and services. GSP's areas of expertise include go-to-market strategies, marketing effectiveness, channel and alliance management, growth strategies, sales productivity and operational improvement. We emphasize pragmatic solutions with measurable results and often work with our clients through implementation.

**Address:**

20 North Clark Street  
Suite 3300  
Chicago, Illinois 606102

**Contact:**

Brad Gillum  
Managing Partner  
312.961.1441  
brad.gillum@gillumstrategy.com

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