

The principles behind ABC Analyzer

Your ability to prioritize time and resources is based on the principle that “some things are more important than others.” This means that your products, customers, and suppliers are not equally important: They do not have the same impact on your profit – and should not be treated equally well.

This article will guide you through the basic theory behind ABC Analyzer and introduce you to 80/20 Analytics®.

- The classic 80/20 rule
- Single ABC categorization
- The double ABC matrix
- Understanding the ABC codes
- Management rules for the different ABC categories



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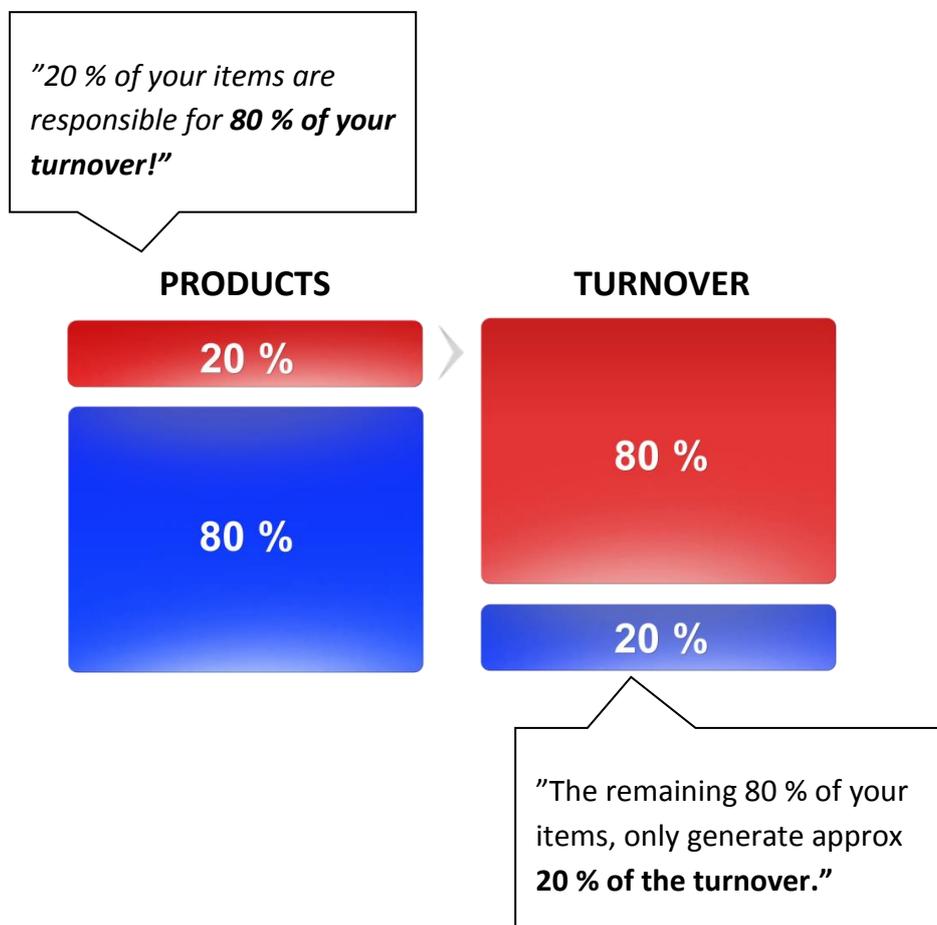
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The classic 80/20 rule

It is not a new idea that some products or customer have a greater impact on your business than others. For approximately 150 years ago, Vilfredo Pareto discovered what today is known as the 80/20 rule: That a fraction of the total, is responsible for the majority of the success. He formulated the discovery as *“roughly 80% of the effects come from 20% of the causes.”*

Today, his discovery is common knowledge known as the “80/20 rule” or the “Pareto principle”, and used within sales, marketing and purchasing.

According to the 80/20 rule:



So, to succeed you need to identify the critical 20 % which define your core business – spent your time on these instead of the remaining 80 %.

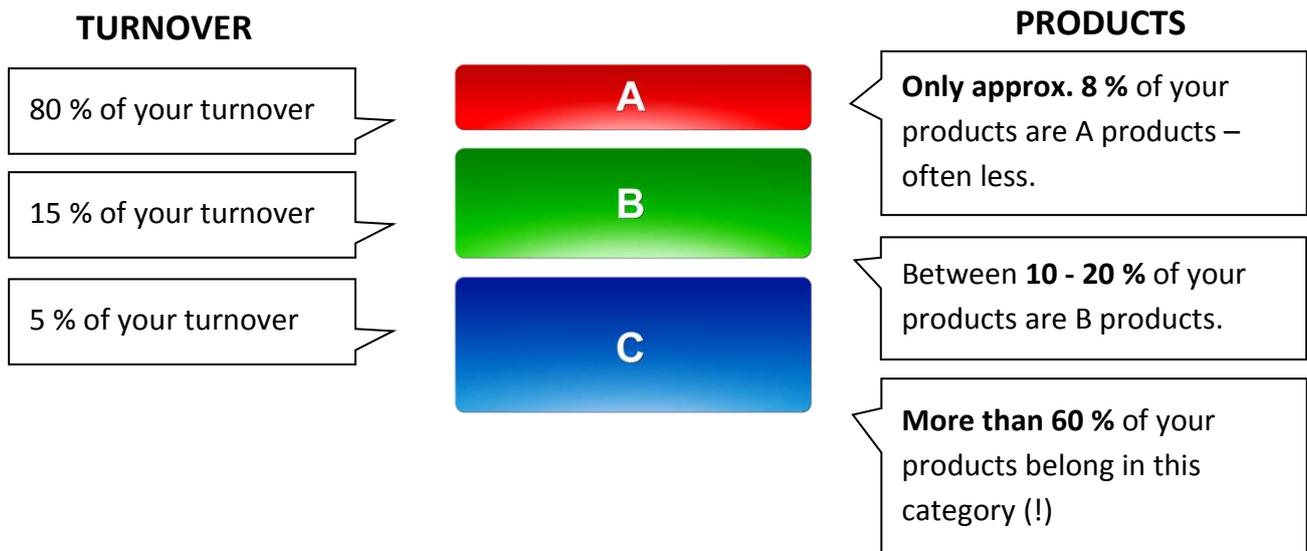
Single ABC categorization

Over the years the 80/20 rule has developed into the classic ABC categorization.

What is an ABC categorization?

In an ABC categorization products are divided into three categories based on how well they perform. Products are divided into categories using an 80/15/5 scale. If you look at the turnover, this means:

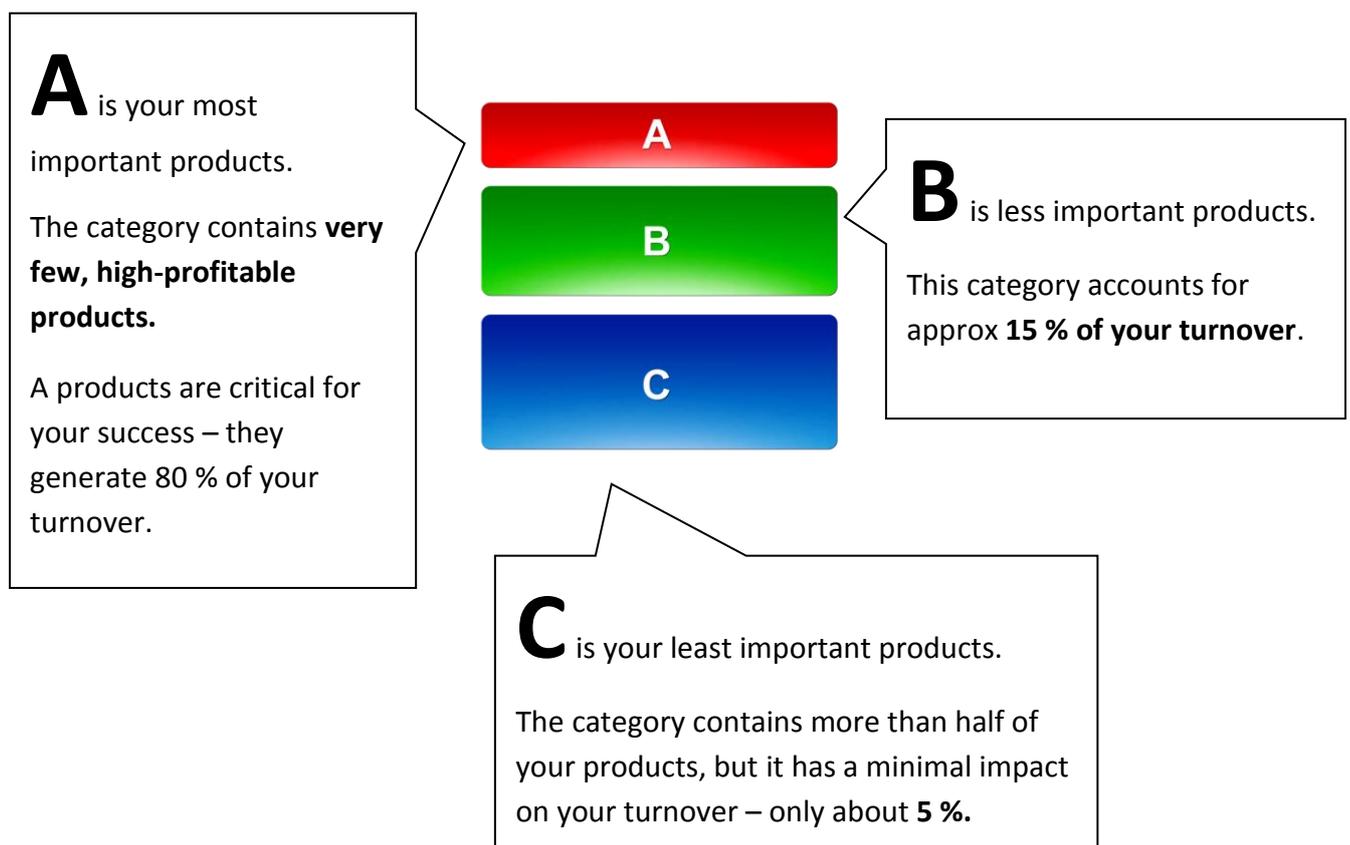
- A items are responsible for 80 % of your turnover (you only have a few)
- B items for 15 % of your turnover
- C items are responsible for the last 5 % (But there is a lot of them!)



Do you communicate ABC with your colleagues?

The ABC categorization provides a language allowing you to talk objectively and mathematically about **which products are more important than others**.

When a product has been labelled "A", you can suddenly justify using more time on it than on a "C" product. So, if both you and your colleagues know the meaning of "A", "B" and "C" products, it is easier to prioritize work assignments and set up rules which ensure that everyone is working on the tasks that create most value.

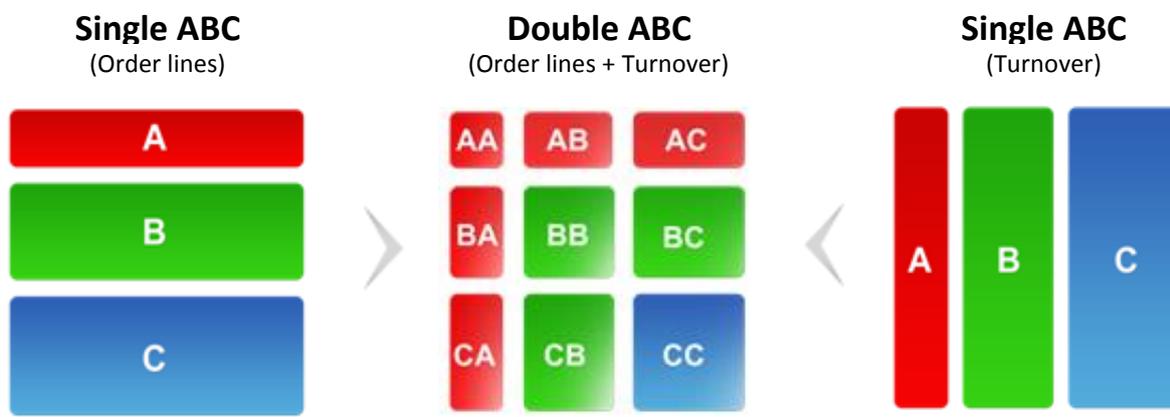


The double ABC matrix

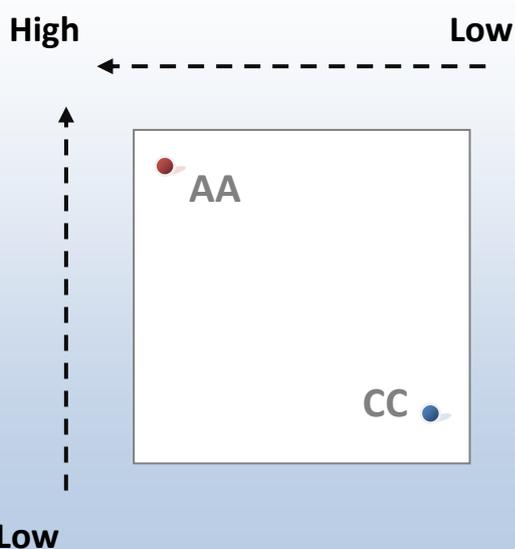
A single ABC categorization provides a snapshot based on **one single parameter**, for example turnover.

It is rarely enough to evaluate a product on a single parameter, take this example: **Two products can have the same turnover, but act very differently.**

To get a better overview, you need to evaluate a product on at least 2 parameters: Order lines and turnover. You do this by making two single ABC categorizations which you combine. Then you have a double ABC categorization.



Understanding the double ABC



The axes of the double ABC

The axes are placed so your most important products are at the top left: The better a product performs, the higher it is placed.

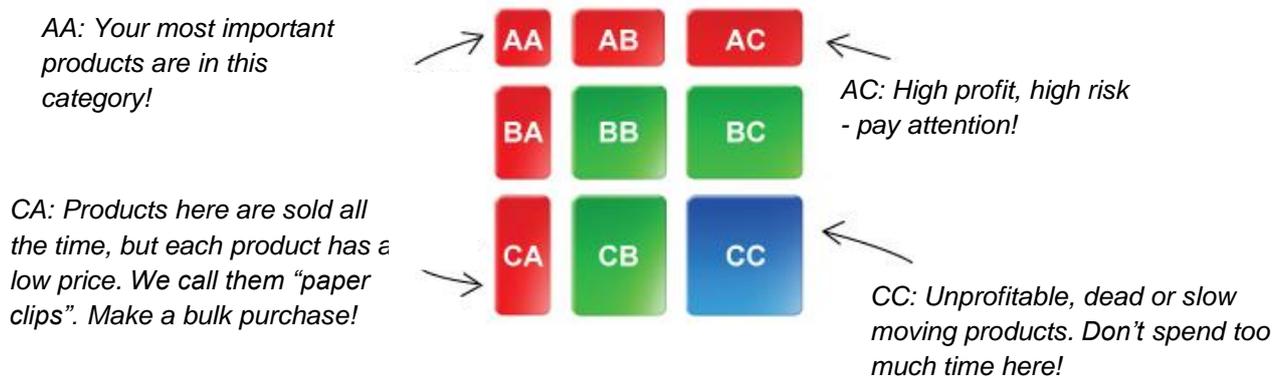
AA: A product which scores "A" in order lines and "A" in turnover is placed top left and named "AA".

CC: Is the product rarely picked, and has almost no impact, it is placed at the bottom right and named CC.

4 crucial cornerstone categories

The double ABC categorization forms the backbone of 80/20 Analytics® and ABC Analyzer. Once you have divided your product portfolio into the different 9 categories, you may begin to create tailored strategies for each category and map different management principles to each one of them.

Take notice: It is particularly the corners AA, AC, CA and CC which are interesting and need your attention, when you are defining your new strategy.



The elevators pitch of the double ABC categorization:

AA are the most profitable products which are sold frequently.

CC are the least profitable products which are rarely sold.

AC are profitable products which are rarely sold (and often irregularly sold too).

CA are products which are sold all the time, but do not generate a lot of money.

Characteristic of the 4 cornerstones

AA are your most profitable products which are sold frequently. They make your core business and need to be treated carefully.

- Often only accounts for 8 % of your total product portfolio.
- Keep a high service standard: Back orders on AA products will have a high consequence for your turnover.
- Even small price adjustments will affect your revenue dramatically.
- Spend time on these products, it is worth it!

CC are products which are least profitable and sold rarely. This category contains dead or dying products too.

- Use minimum time at your CC-products, ROI is limited.
- Consider phase-out or clean up your warehouse – these products just sits on the shelves.

AC are products that are very difficult to manage as they are sold rarely or irregularly, while they have a great impact to your revenue. Make sure a skilled purchaser handles these products.

- Purchase carefully. The risk of unsaleability is high because the products are sold rarely.
- Manage these products manually.

CA are products that are sold all the time but without much impact on the turnover – we call them paper clips.

- Remember: You might not earn much on each product, but your customers buy them all the time = they are important to them!
- Make a bulk purchase to reduce handling costs, unless you run into space problems at the warehouse.
- Keep a high service standard as they are cheap to stock - and without risk!
- Set up automated processes and/or simple guidelines.

Double ABC + extra categories

When you have divided your products portfolio into the 9 ABC categories, you will find out that some products do not really “fit” their category. This makes it difficult to define a single set of guidelines for each category.

Before we can create good strategies for product handling, we must be able to create homogenous categories. Therefore, you need to consider which extra categories you want to add to your ABC categorization.

Consider the following extra categories:

- **New items:** Products on stock less than 180 days.
- **Dead items:** Products with no sales the last year, but with stock value.
- **Phantom items:** Products with no sales, and no stock value.



Depending on how advanced a categorization you want to create, you can add more extra categories and/or more ABC matrixes in ABC Analyzer.

Curious to find out more about ABC Analyzer? Then have a look at all our tutorials [here](#)...

... *or* read about new features and get tips & tricks on how to create cool analyses on our blog:

blog.abcssoftwork.com