# CHAPTER 1

The Trouble with Success

THE TYRANNY OF THE 80/20 RULE

In This Chapter

- The 80/20 Rule is historically relevant and uncannily accurate across industries and generations.
- In financial services, the 80/20 Rule states that approximately 80 percent of your production is derived from approximately 20 percent of your clients. This is an essential understanding and the foundation for Supernova.

There are five stars in the Supernova practice model. They all are contained within the steadfast application of the 80/20 Rule.
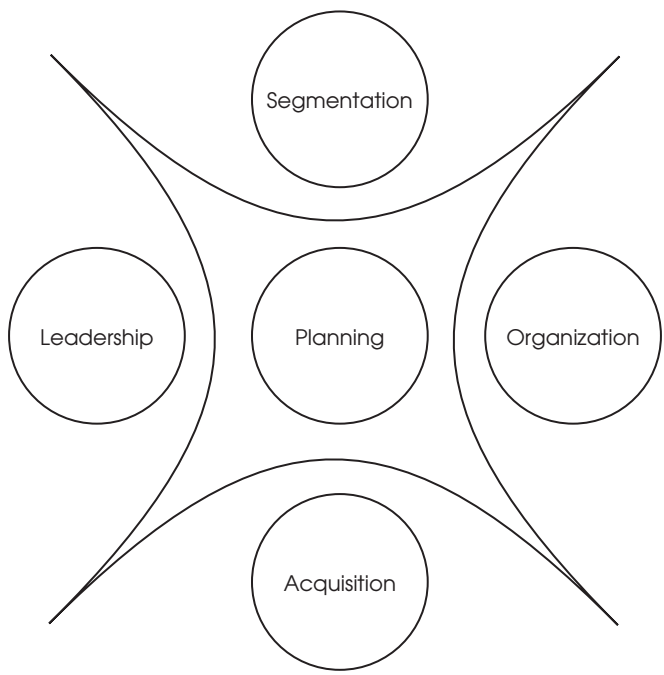
The Five Principles of Supernova

Merrill Lynch Financial Advisor Jim McEnerney was on a binge again. It was before Supernova, and once again, he was having a difficult time saying no to his many clients.

New clients were coming in the door and Jim was holding it open. As he confidently shook their hand, took their money, and then tried, once again, to manage the relationship, you could almost hear him thinking, "I can handle it this time." His confidence was the outgrowth of the past year or so, which had been relatively satisfying—relative, at least, to the year before that. During *that* period, Jim and his team had lost control of their business. Whether they were ready to admit it or not, they were starting to lose control all over again.

Financial advisors (FAs), like Jim, are organized in entrepreneurial groups. These are free-standing businesses with their own strategies, processes, and profits and losses (P&Ls). It's a common structure within the major brokerage and advisory firms. When these groups are working well, they are beautiful businesses to observe, coach, and learn from. When they are dysfunctional, or failing outright, there's still plenty to learn.

This vicious cycle once again seizing Jim was spinning wildly throughout Merrill. There were groups that grasped the intuitive power of the 80/20 Rule and made various attempts to obey it. They ran the gamut from ineffectual to ham-fisted, but they all shared one particular failure: It never lasted. Every time they trimmed their book of business, it was only a matter

of time before saying "no" became impossible once again. It was "yes, yes, and yes" to more clients in an accelerating cycle. They were bingeing again on new business, and like all binges past a certain point, it was getting ugly.

Jim recalls, "It wasn't about staffing; it was about process. We simply didn't have a way to manage our clients, so, naturally, they were managing us—and clients, God bless them, are ruthless managers."

"I wasn't productive. I was dealing with the urgent, but not the important. When I look back on those days, I'm amazed at how far away I was from what I value most. It was unsustainable as a business, but beyond that, it was just wrong."

Unsustainable and just plain wrong. It was also predicted to happen, with precision, well over 100 years ago.

Pareto's Discovery and the Beginning of the Vital Few

The underlying pattern that supports the 80/20 Rule was discovered in 1897 by Vilfredo Pareto, an Italian economist examining patterns of wealth and income in nineteenth-century England. Not surprising then (or now) his research proved that roughly 80 percent of England's wealth was possessed by 20 percent of the people. Yet, his real surprise came in the discovery of a consistent mathematical relationship between the percentage of the population and the percentage of wealth they possessed. He found that this correlation persisted in England, and throughout Europe, in his time and in previous eras. He could demonstrate with relative precision that there was a predictable *imbalance* exerting itself. From that moment on, a series of big thinkers—including the people you'll meet in this book— would put that force to work.

In 1949, Harvard professor George Zipf called the 80/20 Rule the Principle of Least Effort. Building on Parareto's theory of imbalance, he lectured that 20 to 30 percent of productive resources (people, time, skills, etc.) will consistently account for 70 to 80 percent of the activity related to that resource. Again,

he discussed the predicable imbalance that exists, which is counterintuitive to the more common democratic expectation that all clients are equal or that every day has roughly the same significance. Call this the 50/50 Fallacy, because it rarely is fact.

The first guru of the Quality Movement, Joseph Moses Juran alternately called the 80/20 Rule the Pareto Principle or the Rule of the Vital Few. Using the key concepts of this principle, he sought to uncover quality failures and improve reliability. Japanese automobile companies were the first to turn his ideas into business processes. Juran even took up residence in Japan and then returned to the United States. In the States, domestic manufacturers clamored to learn what Japan had mastered: 80 percent of the errors can be traced to 20 percent of the activities. Fix that 20 percent and the cars get better in a hurry.

Even when one suspects there is an imbalance affecting results, the actual numbers tend to exceed our estimation, if not shock us outright. Seeing the documented imbalance in, say, revenue across the business, can freeze us with indecision. Acting on the imbalance means making radical changes, and most people would probably do what Jim McEnerney did—just snap on his blinders and keep plowing.

Because the Money Kept Coming

It was happening at Merrill, just like it happens in nearly every consultative company. There was a culture that rewarded customer accumulation over customer service. It's not that customer service was ignored or considered irrelevant. In fact, the company regularly measured client service and made that information available to every FA. One of the most significant changes in Merrill's business model had made the company more service focused: the migration to annuitized relationships, not merely transactional ones.

As more and more groups within Merrill tied their revenue to their clients' portfolio performance versus what they could sell that month, client service "improved." I add the quotations marks here because, all too often, the so-called improvement was

merely a change in how often an FA contacted a client—instead of calling with a pitch, the FA just didn't call. To many customers, that was indeed an improvement, even if they weren't getting better service.

Despite the annuitized model, the accumulation culture was still alive and well. Gathering assets was where the money was. Teams and FAs were recognized and rewarded for growing their assets under management. Poor service scores were just a sign that the team needed to hire more help for the phones, serve clients better coffee, or something else. No one knew that quality service meant more.

Moreover, incentives to deliver better service weren't part of the picture. The response to poor service score was never punitive. The response to high production was always positive. And during the go-go days of the late 1990s and into 2000, there was plenty of production to reward. Who cared if 20 percent of your clients were generating 80 percent or more of your revenue? The goal was to earn more revenue, not to overthink where it came from. But when that revenue stopped coming, the 80/20 Rule began to matter very much.

But before you move on, let's hear the rest of Jim McEnerney's story. It's where you're heading if you can implement Supernova as well as Jim and his team did. Jim says:

> After we stopped kidding ourselves about where our business was really coming from versus where our time was going, we segmented our book using Supernova. It was a wrenching few weeks, but worth it. I'm a nicer person to be around, believe me.
>
> They don't know the name, but my clients are well aware of how we used the process to reduce our client list down to our very best. They're proud of it actually. We know it's sunk in when they ask us in a meeting if we are accepting new clients.

Final word: Supernova segmentation is *not* about merely reducing your book. It's about giving your clients exceptional service. And the only way to do that is to know who they are.