

## The 80/20 Rule

It was in 1897 that an Italian named Vilfredo Pareto began studying patterns of wealth and income in 19<sup>th</sup> century England. Pareto attempted to mathematically define the distribution of wealth. Of course, he found it was unequal, and that a minority had the wealth.

With this study he identified the first 80/20 rule. 20% of the population in England owned 80% of the wealth. From this first study he began an analysis of other regions and countries, and found the same ratio appropriate.

A brilliant economist, Pareto saw a predictable mathematical relationship in the patterns of wealth and populations; he called this the “Law of the Vital Few.” This valuable theory became known later as the precursor to the 80/20 Rule.

Pareto took the laws of mathematics to a simple first step. By 1949, George Zipf, A Harvard Linguist, found the same principle at works with words. Most words are seldom used, while a few words are used often. Following Pareto’s wealth curve, he defined that the frequency with which a word was used was proportional to 1 divided by the word’s frequency rank amongst all words. This means that the second item occurs half as often as the first and the third item as often as the first, and so on. This became known as Zipf’s Law.

Zipf took it much further. For example, in a 21-block area of Philadelphia, the marriage licenses issued showed that 70% of the marriages were between people who lived no more than 30% of that distance apart.

This type of study became the steps to powerlaw distribution, the  $1/x$  shape that Pareto first saw in his wealth curves. Powerlaws are familiar bell curves that occur where things are different, some are better than others, and effects such as reputation can work to promote to the good, or suppress the bad. Pareto called this the “predictable imbalance of markets, cultures, and society.”

At The Evans Group, we teach and work with Pareto’s 80/20 rule in detail, and find that most of our clients do not fully understand both the value of the distribution rule, nor the mathematics.

- 20% of products account for 80% of revenues
- 20% of our time accounts for 80% of our productivity
- The minority position always has disproportionate value

Mathematically, 80/20 is never quite “exact,” and it makes non-believers “correct” and reduces the value. For example, most of the large inventory markets are 80/10 or less (no more than 10% of products account for 80% of sales).

This is true because it’s not addition math. The 80 and the 20 are percentages of different things, and thus don’t always equal 100. One is a % of products, the other a % of sales.

The 80/20 rule works well with products and revenues, but can just as equally be applied to products and profits. It becomes misunderstood because the assumed implication is to carry the 20% of goods that account for the most sales. Doing this can be true, and valuable, but only if you correctly identify what the 80/20 or 80/10 are correctly.

Do remember that numbers are only facts. Interpretations of facts are what confuse accuracy.

Even cities follow the 80/20 rule. This is why there are cities. People congregate in clusters. Paris or New York, thusly, for whatever the historical or geographic reason, is still following Pareto's 80/20 rule.

Don't begin to stop carrying the 80% of goods, for example, even if 20% account for the 80% of revenue. Decide instead the value of the 80% and if they help lead the 20%, and WHAT is not necessary to carry.

Web based, online, transparent ship businesses allow the Pareto distribution curve to be dramatically increased. Online business can move a business to 98%.

Economies define only neat, easily defined, frameworks that describe real-world phenomena.

In business, the less that is brick and mortar, inventory and infrastructure, the better. Every cost to doing business diminishes profits.

And with that said, let's learn the Pareto curve with the largest retailer in the world...Wal-Mart has fewer selections of products than you "see" in the stores. This is a radical, far reaching statement. Can you identify what we are saying, and why?

**Pareto's Principle or Pareto's Law – 80/20 Rule**  
**20% of something is always responsible for 80% of the results.**

In Management, you can apply the 80/20 Rule in almost anything:

**80% of your time & energy should be focused on 20% of the work that really matters**  
**80% of your problems will come from 20% of your staff**  
**80% of your sales will come from 20% of your sales staff**  
**80% of your sales will come from 20% of your clients**  
**80% of your warehouse space is utilized by 20% of your stock**  
**80% of your stock comes from 20% of your suppliers**

and so on

Some of the key questions The Evans Group asks client's to study are:

- 1) If you are providing product, what % of goods are returned and why?
- 2) What 80% of your business is generated by 20% of your customers?
- 3) With your largest 10 customers, take out the "large jobs" and do a study again using the 80/20 Rule

**Who are your customers?**  
**Who is selling to them?**  
**What are they buying?**  
**Why are they buying?**  
**Why aren't they buying?**  
**What do you need to do to sell them more?**

The answers to these probing questions lead to more strategic focus on generating new business.



The answers may also lead you to look at your internal staff, sales staff, their territory, firing or hiring new staff, pricing, delivery, terms or service. It can lead to improved marketing, flyers, specials, inventory control or internal process changes.

The Evans Group works with you to find these answers. **When you have answers, you'll know what you do best, and can do more of it.**