

MANAGEMENT - THE PARETO PRINCIPLE

At the turn of the 20th century an Italian economist, Vilfredo Pareto, took time to study the division and distribution of wealth in his country. He observed that something in the order of 80 per cent of the nation's wealth and property was in the hands of only 20 per cent of the population. And, if you take the time to look at the distribution of wealth in your own country in the first few years of the 21st century you will, undoubtedly, discover that things have not changed in a century.

For example, in the United Kingdom figures from the Office of National Statistics (ONS) and confirmed by Inland Revenue statistics show that the wealthiest 23% of individuals own 80% of the nation's marketable wealth; this figure is reasonably steady but has been increasing slowly over the last 20 years; that 20% of households have an income less than 60% of the median income; and, that the bottom 50% share round about 2% of the nation's wealth between them and approximately 20% of the population live in relative poverty; this is the only measure that can sensibly be applied in individual countries because of the enormous differences in national wealth. In other words, and despite increases in wealth 20% of the population have not seen any improvement in their lifestyle and standard and quality of living over the last quarter of a century. Similar figures apply for the distribution of wealth in the USA.

However, Pareto's observation led to others in different fields of work to come to similar conclusions and the quality management thinker, Dr Joseph M Duran, determined that in manufacturing 20 per cent of defects caused 80 per cent of the problems with goods and therefore companies should concentrate on resolving the problems with the vital few that matter over the many areas that do not. This rule became known as the Pareto Principle or the 80:20 rule whereby a decision to proceed in a particular direction or adopt a certain marketing policy or even reach a decision to proceed is based on 4 out of 5 agreeing.

Of course the principle or rule is not exact and of course it does not mean that, for example, that 20 per cent of your advertising campaign will create 80 per cent of sales, but it is possible; or that only 20 per cent of your workforce carry out 80 per cent of the work; or that only 20 per cent of your sales force will generate 80 per cent of your profits; or that 80 per cent of your employees will agree with a particular process, procedure, policy or plan.

Can you imagine how much damage it would do to the morale, commitment and efforts of the employees of a company if, for example, a Chief Executive or senior manager had the effrontery or even the stupidity to imply that only one-fifth of his workforce produced the bulk of his profits? They would rightly feel aggrieved at the implication that their efforts counted for nought or at least very little. It would serve him right if many of the employees decided to find work elsewhere and that they and their families and friends decided not to buy or use products from that company again.

And, when it comes to politicians and political systems it does not mean that 20 per cent of the legislation enacted by parliament or a governing body is necessary and that 80 per cent is not, although sometimes it might feel that way. Allegedly a decision to proceed with a particular policy or plan of action is, in some governments, agreed provided that 80 per cent of senior politicians accept the proposition; of course that still means 20 per cent are either not happy or do not accept a particular course of action.

Likewise it does not necessarily mean that 20 per cent of your products will produce 80 per cent of your profits; or that 20 per cent of perpetrators will carry out 80 per cent of all known criminal acts; or, that 20 per cent of pupils will cause 80 per cent of the disruption in school and that 20 per cent will achieve 80 per cent of the highest academic qualifications; or, even that 20 per cent of the policemen on a police force will catch 80 per cent of the criminals, although looking at the latest statistics that also appears to be the case.

Nonetheless, it is quite possible even most probable, for example, that 20 per cent of the world's population produces 80 per cent of all harmful greenhouse gas emissions; that 20 per cent of the employees in a company receive 80 per cent of the wages bill; that 20 per cent of the membership of a professional institute produce 80 per cent of the work and effort that keeps the institute going; or, even that 20 per cent of the people in an organization make and take 80 per cent of all the decisions.

And, on a more practical level it is quite possible that only 20 per cent of the trains travelling to a particular destination carry 80 per cent of the daily, weekly or month passenger figures and that 20 per cent of the roads in a city or town carry 80 per cent of the traffic in the area. Nonetheless, there is, apparently, a degree of truth in the principle and companies and organizations often find that approximately 80 per cent of their business comes from around 20 per cent of their customers.

The questions for any business, indeed any organization is, do you concentrate only on that positive 20 per cent, the ones who provide the bulk of your business, the bulk of your work and effort and generally ignore the other 80 per cent, or do you work harder at encouraging some of the 80 per cent to make greater effort through motivation policies or buy more by offering incentives or discounts or deals, whatever your choice of terminology? However, can any company or organization really afford to ignore smaller customers, those in the 80 per cent group, who only provide 20 per cent of their profits? Who knows, they may be small businesses just starting out and could grow into one of your major customers, or, they could be suffering from a minor blip with their products and about to re-launch new ones.

In some respects it depends on your area of business. For example, common sense dictates that only households with children will purchase items such as school uniforms, smaller size shoes and perhaps even large quantities of household detergents; that households without children are far likely to spend more on such items as gourmet food and wines and other higher quality and higher cost products; that households with more than say 5 occupants are more likely to purchase a people carrier motor car than smaller cars and that households in affluent areas are more likely to buy prestige cars rather than economy models.

I am certain that all major supermarket chains already have systems in place to monitor and check on the spending patterns of individuals and the products they regularly choose. This is done through 'loyalty card' schemes, which collect all the data on when purchases are made, how much, how often and the branding. Likewise large department stores do this through their 'store card' schemes; and, motor car dealerships have already done their homework in this particular area and have identified the groupings that form the 20 per cent of their customers who provide 80 per cent of their profits.

That is why if and when you purchase a motor car from a reputable marque you are likely to end up on a mailing list, at least for a few years, that sends you glossy brochures and literature just to remind you they are still there should you wish to change your car in the future. But, does that mean all these companies should be selective in the media they use to advertise their products or services; does it mean that they do not concern themselves over the 80 per cent who might purchase products or services only occasionally?

With respect to advertising the more reputable and more costly the motor car, for example, the more selective they are likely to be with the type of magazine in which they advertise simply because different people choose to read different types of magazine. However, all motor car companies will advertise in local newspapers because no company, no organization can seriously afford to put all their eggs in a few baskets and ignore other customers because it is possible that some of the smaller customers might become bigger customers over time.

It is up to companies and organizations to make a study of those areas that apparently cause problems and then produce information and statistics and take decisive action to resolve difficulties. Besides, whether the Pareto Principle applies or not any organization worth its salt will have a grip on relevant statistics that show where business and profits are generated and where they are failing, and they should be taking action to address weaker areas on a regular basis; if they do not then it is time to find some new directors.

(1555 words)

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