PARETO PRINCIPLE

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10-26-18

My first thought after receiving this assignment on the Pareto Principle was to wonder just who I had offended on the Selection Committee. I had no idea what the Pareto Principle was so… I googled it. The Pareto Principle revolves around the 80/20 relationship. Eighty percent of the consequences (or results) come from 20 percent of the causes.

For over twenty-five years my experience was centered around retail sales. As applied there, you might have expected 80% of your sales to come from 20% of your customers. In a few minutes I'll give you my thoughts on that.

The Pareto Principle was first put forward by an Italian Economist, named Wilfredo Pareto, in either 1895 or 1906, depending on your source. According to a 2016 article in

Forbes Magazine, by Kevin Kruse, Pareto first noted that around 20% of the plants in his pea pod garden generated 80% of the healthy pea pods. In a more serious view, he found that 80% of the land in Italy was owned by 20% of the population and that 80% of production came from 20% of companies. Kruse goes on to say that the generalization became “80% of the results come from just 20% of the action”.

80/20 is not meant to be specifically 80/20; it should suggest a range that various relationships of factors can settle into. It can also suggest a starting point for improvement as we will see later in the paper. It was in the 1940’s that a popular management consultant named Dr Joseph M. Suran started referring the 80/20 relationship as the Pareto Principle, because of Pareto’s earlier work. Paretto’s Principle aligned closely with Suran’s philosophy that he referred to as “The Vital Few and Trivial Many.” In

fact because of Suran's successful application of Paretto to various business problems, some have suggested renaming it "Suran's Principle". However Pareto has stuck.

One important thing to remember as I mentioned a moment ago, is that 80/20 is not hard and fast and when logic dictates you may want to veer from strict adherence.

It was because Pareto's first serious application of 80/20 was with wealth distribution, I wanted to see what more current figures would show for the United States. Because of casual reading I suspected that wealth had grown more concentrated among a smaller percentage of people. In 2007 the richest 1% controlled 34.6% of the country's total wealth and the next 19% owned 50.5%, so the bottom 80% owned 15%. If you were in that 80% it's roughly equivalent to saying you graduated in the top 95% of your class – You didn't do too well, but that was at the start of the

great recession. As the recovery took hold those outside the top levels of wealth did not keep up percentage wise.

By 2014 the top 1% controlled 40% of the wealth and the bottom 80% had fallen to 7% (Boyer, Dave 1/24/14, Washington Times). This is veering pretty far from the normalizing 80/20 and Paretto's original results in Italy, and hurts not only the lowest levels of wealth, but eats into the consumer power of the Middle Class which has long been the secret of our Country's economic success. To help scale this, an Oxfam study in 2017 estimated that eight rich people (six of them Americans) own as much combined wealth as half the human race.

But, the purpose of this paper is not to solve the wealth gap, but to explain 80/20. My earlier figures from 2007 were sourced from a book titled, The Pareto Principle Handbook, by someone named Stephanie Bright. In the table of contents listed on page 38 there was something under the title of “Womanizing and Human Promiscuity”. Remember this is from the Paretto Principle Handbook.

So, being on a quest, and hungry for knowledge of all things 80/20, I beat a path to page 38 and here is what I found, “The number of sexual partners people have had in their lifetimes varies widely within a population. A 2007 Nationwide Survey in the United States found the median number of female sexual partners reported by men was seven and the median number of male partners, reported by women was four.” The obvious conclusion here is that the men, go figure, were lying. Locker room talk indeed!

Now at no time could I see, since the men were lying, any sound application of the 80/20 principle. While I’m left scratching my head as to how this ties in, Ms. Bright ends her thought by suggesting that these various couplings result from assortative mixing within one’s own social group. And while I didn't look up "Assortative Mixing" I think I've got a pretty good idea of what it means!

Ok, so at this point I kind of knew what the Pareto Principle was, but really a whole paper on it? I mentioned my assignment to another club member and though they were almost as dismayed as I, they went on to suggest that; well it is a Quest and you can make the topic your own. Since I'm interested in current events and history, I tried approaching it from that same point. How could 80/20 be applied to the Cuban Missile Crisis or the Civil Rights Act of 1964. But…as interesting and meaty as those topics are, I could not with a straight face, contort them into some sort of 80/20 analysis.

So I approached the 80/20 principle, while somewhat lacking in enthusiasm, with a sense of determination and somewhat more dedication.

First of all it's tempting to look at 80/20 analysis as some sort of great solution for all of a businesses' problems. If 80% of your results come from just 20% of your customers, simply focus your time and resources on the 20% of customers and don't worry so much about the remaining 80%. Or if 20% of your sales people give you 80% of your sales why worry about the rest of the sales people. There is even a subset of 80/20 that is promoted – 4% - 64%. The 4% represents 20% of 20%, and 64% is 80% of 80%. This group of sales people or customers would represent the super stars of your particular group. Four percent of your sources would yield 64% of results. This is kind of like hitting the Lottery. But focusing solely on these numbers has some obvious shortcomings. Undoubtedly there are some low producing customers, or sales people, that need to be purged from time to time, but what about those who can, with some attention or training, be persuaded to join that top 20%. Let alone that 4% group. Success can come from unexpected places. Now as you might expect in today's world where people look for easy answers to life's fulfillment and business success, there are those who offer with an evangelical fervor, seminars, webinars and books, that provide, after you write a check, all of the answers. So you can imagine a smooth talking speaker in a great suit with one of those neat microphones that snake around from your ear to the side of your face, all espousing slogans like: Eat the Biggest frog first, meaning take on the toughest problem first or resist the urge to clear up small things first. These are neat slogans and while consultants are certainly helpful, proper 80/20 analysis devolves into time study and/or goal setting. A website called, Wanderlust Workers.com, quotes Confucius "Success depends on previous preparation, and without such preparation, there is sure to be failure."

The article from that website goes on to outline a step by step process for understanding and using the 80/20 principle.

Step 1 – Identify what your goals are, what is it you want to accomplish?

Step 2 – Track your progress – this is more the time study part. Analyze how you or your people are spending their time. What works to garner results and what does not.

Step 3 – Identify the 80/20. Where is the 80% coming from?

Step 4 – Scale your results. I had trouble understanding what this means. I think it's something like when you have identified the profitable 20% you should or can spend less time on the bottom of the remaining 80%. In theory this allows more time to nurture the "good" 20% as well as finding other possible additions to the 20%.

Step 5 – Finally identify the 20%, of the 20%, or 4%. These are the real superstars. If you can maximize this group, your desired results can grow exponentially.

To, presumably maximize your 80/20 efforts; the consultant Brian Tracy writes that there are three keys to living and working without constraining limits:

1. Clarify of your desires, goals and vision: know what you want.
2. Be competent in your key areas of your chosen field.
3. Concentration – Have self-discipline to focus on achieving your goal

While these steps and keys are undoubtedly important for success, I tend to have my eyes glaze over if I detect too much of a religious fervor in the adaption of a particular philosophy. “Eat the biggest frog first” kind of looses me.

What I have to offer today are some examples of real world companies – a couple of positive and one negative. My real world examples, at least, may show a less strict adherence to the rules of 80/20.

I'll start with the negative. The Company is, maybe not surprisingly, Rogers Markets. Started in 1944 and owned by about 125 local investors. The first store was of the twenty foot wide and maybe 1,000 s.f. variety. Subsequent post War stores ballooned all the way up to 20,000s.f., and our largest eventually was 65,000 s.f. For comparison the two current Kroger Market stores are between 120 and 130,000 sf. But, we thought our stores were a big deal at the time. By the late 80's our marketing area had grown to encompass all of Allen County with some penetration into Noble County. We sold to rural and urban residents and black, white and brown customers as well as other minorities and all religious backgrounds. Were we somehow more advanced or egalitarian in our thinking – nope! This was our Market, if we didn't serve it, Scott's or Maloley's would. We all took a lot of pride in taking care of customers wishes big and small. And, this does lend itself to 80/20 somewhat in that we were trying to build customer loyalty. If we had a case of merchandise at a north store that was needed at a store located on the south side of town, we jumped into a station wagon and went and delivered it; sometimes to the person's home. At no time however, did we do a time study to analyze the cost of this effort. We just took care of the customer. Time study and cost benefit analysis are foundations of the 80/20 Principle.

If we were wrong in our marketing strategy – it was that we did not customize stores to their individual markets. One of the other businesses I report on will examine that.

While I don't know any special secrets of Kroger or Wal-Mart, I do know that shelf allocation is very important.

Next time you're in a Kroger store, notice the placement of Kroger or so-called house brands. These brands, while high quality are generally lower priced than National Brands, but carry a higher gross profit for the retailer. These are the ones that are placed at eye level, within easy reach – almost guaranteeing more sales. If, you see a National Brand in these positions, it is likely that higher allowances have been paid by the manufacturer to secure advantageous placement.

With house brands the idea is that even though the price is lower you will sell more and earn a higher cumulative gross profit. This is a clever refinement of original philosophy of "worry about the top line (sales) and everything else takes care of itself." Today however things are more complicated than just worrying about sales. As labor is generally the largest expense, it needs to be managed carefully. Questions such as – how do you get the

most from the fewest employees, how far do you let checkout lanes back up, or how do we get more people to use the self-serve checkout lanes? These questions become very important.

While I’m not sure how an 80/20 analysis would have worked for our former business, these modern retailers are trying to maximize certain sales and perhaps improve on their own 80/20 concept. We however existed to take care of the customer, whoever they were or wherever they were in our marketing area.

I’d like to switch now to another grocery store example that I think positively uses their 80%-20% analysis to focus on a particular market. The store is George’s International Grocery. While they certainly offer a wide variety of international foods, they seem to take particular care of their Latino or Hispanic customers.

First a little history: Rogers Markets purchased the store operation at Broadway and Taylor, where George's is currently located, from the Didier Brothers in 1978; the building itself was owned by a Trust at Fort Wayne National Bank. We operated the store until 2000, when George Rongos and his family purchased the building and indicated that they wanted to move their then existing store from further west on Taylor to our location at Broadway. We were able to arrive at a deal selling them our interest in the store. And over the years we have maintained a friendly business relationship with George and his sons; Chris, Jerry and Jimmy. Chris helped me with this portion of the paper and we are Jimmy's landlord at Dupont Crossing, for his Ziano's restaurant.

George is a Greek Immigrant, coming to this Country at age nineteen. George's is the story of the Proverbial Immigrant arriving here with very little money and not much more than a desire for success. But at 19 years of age he had a dream. He worked at Joselyn Steel, and then started a Greek and Italian Food Store. George had, and still has an Elvis like pompadour haircut and played guitar in a rock band. Even though he could not read or write in English at the time, the family sought out deals on merchandise, even if George had to get in his truck and drive out of town to get it.

With three growing sons, that George and his wife were raising, his goal was to provide jobs for them. Incidentally George's now 54 year marriage was an arranged one. He traveled back across the Atlantic on the Queen Mary and met and married his Greek wife in 24 hours.

But back to jobs. There was a small store across from Jocelyn Steel. Eventually George marshaled the capital to buy the business and provide jobs for the family.

Over time he and the boys and Mrs. Rongos, built the business by hard work. But at first sales weren't great and while they weren't exactly failing, they weren't setting the world on fire either.

One day a friend/customer gave them some serious advice – look at your customer base. There was and is a large amount of Hispanic customers living nearby but they were not being properly served with the kind of products that they wanted. This friend gave George a starter list of products to buy. That first weekend they sold out of their new products and word spread.

Today George's is as successful as ever and George is still there every day, sons Chris and Jerry handle operations. Chris and Jerry also operate the Salsa Grill Restaurants, while Jimmy is the owner of the afore mentioned Zianos Italian restaurants. And culture abounds in their businesses. George's is the site of Western Union

Money transfers to Mexico, with workers here supporting families back home. In the past buses left from George's going to our southern border. And in a different kind of cultural exposure, I walked in their store one morning to see and hear Chris on the phone, surrounded by Latino customers, while speaking fluent Greek, but swearing in explicit English – is America a great country or what? George's family business does millions of dollars in revenue and employs over a hundred people. Not bad for a poor immigrant with minimal prospects.

But do the numbers support an 80/20 approach? I looked at where George's derive their sales and who their customers are. The 2010 Census information lists Allen County as having about a 6.5 % Hispanic population and Wayne Township is at 12.5%. However, Census tracts 2000 to 2100 closest to George's show a population 17.4% and 30.7% respectively that are Hispanic. This gets close to

averaging 20% +. In the grocery business customers or market penetration is greatest within a mile or two of the store’s location. Think of a stone dropped in a pond. The resulting ripples closed to where the stone was dropped are the largest, or the most customers. As you get further away the ripples lessen in their intensity, or fewer customers. What George did was analyze his customers and adapt to that reality. In other words, here was a large population not being served. This 20+% could turn into the 80% of sales.

When I walked thru the store. I was amazed at the different products and their presentation. Other than staple products, I did not recognize a lot of products or the manufacturers, yet the customers were snapping them up.

Forty years ago when we started operating at Broadway Taylor we served a largely white and black, blue collar customer base. As the neighborhood expanded its cultural diversity I don’t recall that we recognized the opportunity. George and his wife and sons, with help and advice, saw that this approximately 20% of customer base could be serviced better in an attempt to capture and maximize their sales and profits, thereby using the 80/20 Principle to the company's benefit and satisfying an important market and allowing them to maintain some of their fringe customers as well.

Now, about 2 miles or so to the north of George's, by the railroad over pass, near the end of Main Street sits a non-descript old factory building. Painted white, with black and gold signs on it. On Saturdays, in good weather, the parking lot is the site of a small farmers market. But more importantly during the week it is home to Power Components, an industrial supplier of hoses, fittings and machinery belts among other things. Everything you need to keep your industrial plant running. Co-owner Jim Geyer Jr. traces the company's evolution back to the founding of

Transmission Fluid Equipment in 1964. Jim's father James Sr. along with several partners founded the company with the intent of supplying what else? Transmission fluid equipment to Industry. By 1985 the Jims, Sr. and Jr. owned the company along with a surviving partner.

In 1993 the Geyers' sold their interest in TFE and so at age 38 Jim Jr. found himself with a nice contract salary, but also a non-compete clause, that kept him from working in any related business. So he took a sabbatical in the real estate and construction business. In 1998 when the non-compete ended Jim and his dad purchased Power Components. Over the years Power Components has additionally developed into one of the area's top suppliers of hoses and couplings, as well as hydraulic fittings. They also supply pneumatic brass fittings and nylon, copper and steel twine along with electric motors and conveyor belts.

What the new owners found in 1998 however, was that instead of an 80/20 or 64/4 customer sales spread they had approximately fifty customers on a regular basis. Of those fifty about 5 or 10% were responsible for 95% of sales. The reality of losing one or two of those, was possible sales devastation. So the challenge became not only holding on to the top five, but growing the next 45 customers to gain sales stability.

As with most problems of any type there usually is no silver bullet for an answer. So over the years Power Components has developed a number of strategies to build and maintain customer satisfaction and confidence.

They have sales people on the road going from customer to customer to not only take orders but deliver parts as well. When a machine breaks down – the factory can't afford for a part to ship, they need it now. Power also has certain high volume parts arranged in bins in aisles where the customer can shop as if they were in a retail store.

And in a nod to the no fuss-no muss internet sales era they have added what is essentially a will call sales area that allows the customer to use the internet to place an order and pay for it online. The order is then packaged and placed on a will call shelf (kind of like Panera and Starbucks) where the customer can walk in, pick up the order, and simply walk out. This is another way of cutting down time at the factory level.

These methods along with consistent pricing as-opposed to opportunity pricing (IE charging more when someone is in a pinch) build customer trust and satisfaction.

While no company achieves level sales success these methods have helped Power Components lock in their top customers as well as build sales in that next tier. And contrary to what I said earlier about 4-64, a static 5-95 relationship is way too dependent on what is a small per cent age of a small base of customers,

Now I'd like to pivot to what else – the 80/20 Company. Located on highway 30 near Columbia City. They refer to their products as the industrial erector set. The company was founded by Don Wood, spouse of Questor Dar Richards, and is now run by his son John Wood.

For this part of the paper I spoke with Rod Strack in Human Resources at 80/20. Rod has been with the company for 22 years and to say that he's enthused about his job and the company as a whole might be an understatement. He explained that Don Wood started the company about 30 years ago in the Enterprise Center off South Anthony Blvd. here in Fort Wayne. In 1995 they moved into the old location of Champion Doors & Windows on highway 30 east of Columbia City.

The industrial erector set product that they make is industrial racking that can be constructed in various configurations in residential as well as commercial applications. It's kind of like a heavy-duty Lego set that you can custom design for specific uses. The basic building block is an inverted "T" slot system that slides together thus, reducing the need for a lot of tools to construct it. In a commercial retail situation this product might be used to store excess inventory in the backroom. In some cases it can be used for retail sales in various type stores. They can make almost any kind of shelf or cart, I even saw a picture of dividers in the storage area of a fire truck. And they can design and make architectural products. I saw a picture of a large commercial metal staircase on their web site that while different, was pretty neat. They like to say that "they make a place to put stuff", or in this case a place to walk on.

But 80/20's product is not restricted to commercial use. They are happy to talk with individual residential users that have a need for something like garage storage. This in fact makes them kind of unique. Rod Strack told me that nothing is too big or too small for them to look at.

They prefer not to lean on too many big customers, and they like to see blueprints or discuss ideas face to face in order to arrive at customer solutions. I would note that lack of dependence on larger customers also sort of goes against the grain of the philosophy. While they have a website and do business in 48 states and sixty countries, they prefer to do business on a one to one basis. Their website serves more as a point of contact, not as the end sales tool. The company emphasizes customer assistance. From custom machining certain parts to partially assembling or completely assembling whole units. They estimate that they can assemble units in 25% of the time that it would take the customer to do the same work.

Over time the company has had a great amount of growth. Thirty years ago they started out in three thousand square feet, today they occupy 300,000 square feet and employ over 400 people.

A long time ago I attended a seminar hosted by Don Wood, and while I don't remember the exact topic, I do remember his enthusiasm and concentration on customer satisfaction. In retrospect maybe we were, unknowingly, using some 80/20 methods at Rogers.

Near the end of my conversation with Rod Strack, he underlined the idea that the 80/20 philosophy is not a panacea in and of itself. One you've done a proper analysis, 80/20 is a starting point for building revenue and profit strength. And I really think that is the key for the 80-20 company They are trying to treat every customer as if they were in or had the potential to be in the top 20% of customers. The company's philosophy centers around not only 80-20 but attitude as well. Attitude not only toward the job, but attitude toward the customer.

In closing, the way I approached this paper, despite some of my early grousing, was different, I depended more sitting down with individuals and asking them about their businesses. I thought it was fun to sit at Starbucks with a cup of coffee and a pad of paper and get people to open up about business. I found that confident and successful people not only tell you what works, but what does not. Sometimes you have to fail before you succeed. But, I think that's what 80/20 is about. You find what works and then improve on the 80/20 split.

Sources:

1. Specific facts are credited within the body of the paper.
2. In person interviews with Chris Rongos and Jim Geyer.
3. Phone interview with Rod Strack.