

The 80/20 Principle

How To Use It To Increase Profits

By

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Committed To Your Business Success

In 1906 Vilfredo Pareto the Italian economist, through his research made the famous observation that twenty percent of the population owned eighty percent of the property in Italy.

This rule is often referred to as the 80/20 rule and has been the topic of many business articles and discussions.

The Pareto Principle says; that in most cases, 80% of production comes from 20% of producers.

You may have heard people say that 80% of the sales come from 20% of the sales force.

Or that 20% of your customers are responsible for 80% of your profits.

When you start to dig into your business, applying the principle; it can have a profound effect on how you should use your resources and your profitability.

Some customers could be using a disproportionate amount of yours and your team's time and those customers could be the ones that are yielding you the least value.

It's plausible that in those circumstances, that the customers who are most profitable get neglected and additional sales which could be obtained from them, do not materialise, because you are spending too much time on the problem customers.

The trick here is to know; which is the right 20%. To find out where the greatest opportunity for making improvements are; where in your business can the best performance can be extracted? Where are the 80%, sub optimal areas in your business and what can be done about it?

Let's just take the **theme of contribution from customers.**

Make a list of sales and gross profits by client/customer over the last twelve months.

Put the list into a spreadsheet.

Client Sales Gross Profit

Then consider all overheads; like service back up, account management, accounting department costs, etc and overhead costs that are being used to support particular customers.

Calculate what those costs might be and subtract them from the gross profit figure by customer.

This is a very rough and ready activity based budgeting approach.

What it should tell you is; approximately how much money you are really making, when you consider the overheads being used by particular customers.

So which customers use the most resources? Which are your most profitable?

Rank these customers in order to find out who the top 20% are in terms of profits.

This kind of information can lead you to make some strategic decisions; such as increasing the service to the best customers to achieve greater customer retention, higher sales value and more referrals. And reducing the resources applied to other types of customer.

It may even influence your decisions in terms of the type of customers you really want.

This approach can be also applied to **market segmentation**: If you have different products/services that are being sold to different market segments i.e. specific types of customer or by geographic location etc. You can apply the same ranking system. Allocating costs and ranking your segments by order of profit.

Turning back to the sales force; which could be in a small business, the owner plus one other person, the same principle applies; firstly undertake an analysis of your figures.

Find out who is bringing in the orders and the value in relation to client profitability.

Should you give the same resources to each salesperson?

If you gave greater support to the most successful salesperson would it be possible to improve their results further?

What are the most successful salespeople doing as opposed to the least successful?

What can you do to bring them up to the same standard?

Given that we know that all prospects are not created equal are your salespeople spending their time proportionately?

Production; is 80% of your resources being used on low profit work? Are your production

problems being solved by 20% of your people? Or are 80% of your problems being caused by 20% of your people?

Quality; are 80% of your defects found in 20% of all products/services? What can you and your team do about addressing the 20% of all products/services where the defects are to be found?

Employee Retention; if 20% of the workforce are identified as the star performers, what can you do to make sure these 20% stay and what can be done to improve the 80% to achieve similar results to the 20%? Could you give better benefits and bonuses related to performance? Could you make visible the rewards to encourage other employees to achieve the same standards?

Time Management; does 20% of your time make a real difference to the bottom-line and is 80% low value? What could you do to do more of the 20% and get rid of the 80% low value work?

I came across this problem with one of my clients; I found that he was the company's best salesperson. I advised him to bring in two part time assistances to free his time up, so he could spend more time selling. Sales went up 150% a month later after he got rid of a lot of his, low value work.

Where else can you apply the 80/20 rule to improve your business?

I hope you've enjoyed this article, if you want to know more about the subject or have any questions relating to growing your business, you can call me on **01623 720022** during normal business hours or click this [link](#) to let me know when it's a good time to talk.

How successful do you want to be?

Sincerely

A handwritten signature in black ink that reads "Mark". The signature is written in a cursive style with a horizontal line underneath the name.

Mark Wheatley

Mark Wheatley is a business growth and marketing expert who specialises in growing small to medium sized businesses through low risk marketing strategies and improving sales skills.