

Multi-level marketing

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Key concepts [show]
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Multi-level marketing (MLM), also called **pyramid selling**,^{[1][2][3][4]} **network marketing**,^{[3][5][6]} and **referral marketing**,^[7] is a controversial [marketing strategy](#) where an MLM company's [revenue](#) and [profit](#) is derived from a non-salaried [workforce](#) (called "salespeople", "distributors", "consultants", "promoters", "independent business owners", etc) selling the company's products/services, while the earnings of this non-salaried workforce is derived from a pyramid-shaped [commission](#) system via two potential [revenue streams](#) which, although dictated according to each MLM company's specific "compensation plan", has two common features across all MLMs: firstly, from commissions on sales by participants directly to their own retail customers, and secondly, from commissions based on the sales by other distributors below them who they had recruited into the MLM (in the organizational hierarchy, known as their “down line” distributors).^[8]

MLM salespeople are, therefore, expected to sell products directly to end-user retail consumers by means of relationship referrals and [word of mouth](#) marketing. Most importantly, however, they are incentivized to recruit others to join the company as fellow salespeople so that these can become their down line distributors.^{[5][9][10]}

Contents

- 1 [Business model](#)
 - 1.1 [Revenue streams](#)
 - 1.2 [Profits and losses](#)
 - 1.3 [Participant consumerism](#)
 - 1.4 [Distribution of profit to participants](#)
 - 1.5 [Participant movement](#)
 - 1.6 [Participant financial loss, company financial gain](#)
 - 1.7 [Selling the dream, then the product or service](#)
 - 1.8 [Not a pyramid scheme in the traditional sense](#)
 - 1.9 [Employment law](#)

- [1.10 Lawsuits](#)
- [2 Direct selling and network marketing](#)
- [3 History](#)
- [4 Setup](#)
 - [4.1 Pyramidal structure](#)
- [5 Income levels](#)
- [6 Legality and legitimacy](#)
 - [6.1 United States](#)
 - [6.1.1 Criticism](#)
 - [6.2 China](#)
- [7 See also](#)
- [8 References](#)
- [9 External links](#)

Business model

Revenue streams

In the MLM business model, the commission derived from the MLM pyramid structure (i.e. from the sales of one's recruits) is the most profitable revenue stream. This revenue stream, however, is also the least statistically probable source of remuneration to a salesperson.

Conversely, the revenue stream from direct-sales of ones own personal sales is the least profitable. This revenue stream, however, is also statistically the most likely source of remuneration to salespeople.

Profits and losses

The overwhelming majority of MLM participants (most sources estimated to be over 99.25% of all MLM participants) participate at either an insignificant or nil net profit. Indeed, the largest proportion of participants must operate at a net loss (after expenses are deducted) so that the few individuals in the upper levels of the MLM participants pyramid can derive their emphasized significant earnings.

Participant consumerism

Consumers of an MLM company's products/services can, in theory, be merely end-user retail consumers (i.e. non-participants of the MLM company, with their relationship to the MLM company as nothing more than in a capacity of consumers). In actual practice, however, the overwhelmingly majority of consumers of MLM products/services are the participants (the very "salespeople") within the MLM pyramid who had been recruited by a fellow participant positioned above them in the MLM participant pyramid.

Revenue and total profit of the MLM company is thus largely generated from the pockets of participants within the MLM pyramid who are simultaneously both salespersons and consumers at once. It is only an insignificantly small proportion of revenue and total profit that is derived from non-participant retail consumers who are outside of the MLM participant pyramid.

Many MLM companies will not disclose what percentage of its consumers are simultaneously their own participants. Other MLMs do not keep said figures because they do not differentiate between participant consumers and non-participant retail consumers.

Distribution of profit to participants

It is important to distinguish between the MLM company itself versus the so-called "independent businesses" run by the MLM participants.

The percentage of an MLM company's total profit which is ultimately distributed to its contingent of salespeople, away from the MLM owners or shareholders, differs from one MLM company to the next. However, the percentage earmarked to be paid to salespeople is usually a smaller share of overall company profits.

The earmarked figure is then distributed in complex compensation plans which, ultimately, funnel most of it to a few individual salespeople/participants in the upper-most levels of the MLM participant pyramid. The remaining majority of participants (often over 99.5% or more) receive no returns, or negligible return which are more often than not at a [net loss](#) after they deduct expenses which were incurred in the promotion of their "independent businesses".

Participant movement

While participants' movement up the pyramid of an MLM can be accomplished in theory, and indeed this is one of the distinguishing factors between MLMs and traditional [pyramid schemes](#) (besides featuring actual sales of products or services), said upward movement is so extremely improbable so as to render it practically impossible, despite all efforts and investments of time and money by a salesperson.

Participant financial loss, company financial gain

The end result of the MLM business model is, therefore, one of a company (the MLM company) selling its products/services through a non-salaried workforce (participants) working for the MLM company for free while the participants simultaneously constitute the overwhelming majority of the very consumers of the MLM company's products/service that they, as participants of the MLM, are selling to each other in the hope of one day themselves being at the top of the pyramid. This creates great profit for the MLM company's actual owners and shareholders.

Indeed, many MLM companies generate hundreds of millions to billions in annual revenue. However, those company profits are derived to the detriment of the overwhelming majority of the company's non-salaried workforce (the MLM participants). Only some of the profit is then significantly shared with none but a few few individual participants at the top of the MLM participant pyramid.

The earnings of those top few participants then allows the creation of an illusion of how one can potentially become financially successful if one becomes a participant in the MLM. This is then emphasized and advertized by the MLM company to recruit more participants to participate in the MLM with a false anticipation of earning margins which are in reality merely theoretical and statistically improbable.

Although an MLM company holds out those few top individual participants as successful, the reality is that the MLM business model depends on the failure of the overwhelming majority of participants through the injecting of participant money from their own pockets to become the revenue and profit of the MLM company.

Participants, other than the few individuals at the top, provide nothing more than their own financial loss for the company's own profit and the profit of the top few individual participants.

Selling the dream, then the product or service

The main sales pitch of MLM companies to their participants and prospective participants is not the MLM' company's products/services. The products/services are largely peripheral to the MLM model. Rather, the true sales pitch and emphasis is on a false confidence given to participants of potential financial independence through participation in the MLM. This is referred to as selling the dream.

Though emphasis is always made on the potential of success and the positive life change that "might" or "could" (not "will" or "can") result, it is only in otherwise difficult to find disclosure statements (or at the very least, difficult to read and interpret disclosure statements), that MLM participants are given [fine print](#) disclaimers that they as participants should not rely on the earning results of other participants in the highest levels of the MLM participant pyramid as an indication of what they should expect to earn.

MLMs very rarely emphasize the extreme likelihood of failure, or the extreme likelihood of financial loss, from participation in MLM, nor are they forthcoming about the fact that any significant success of the few individuals at the top is in fact dependant on the continued financial loss and failure of those participants below them in the MLM pyramid.

Not a pyramid scheme in the traditional sense

MLMs have been made illegal in some jurisdictions as a mere variation of the traditional [pyramid scheme](#), including in mainland [China](#).^{[11][12]} In jurisdictions where MLMs have not been made illegal, many illegal pyramid schemes attempt to present themselves as MLM businesses.^[10]

Given the fact that the overwhelming majority of MLM participants cannot realistically make a net profit, let alone a significant net profit, but instead overwhelmingly operate at net losses, some sources have defined all MLMs as a type of pyramid scheme, even if they have not been made illegal like traditional pyramid schemes through [legislative statutes](#).^{[7][13][14]} This is despite the fact that MLM companies (as opposed to the "independent businesses" run by participants) generate multimillion-dollar profits for the MLM owners and shareholders.

By the very nature of the MLM model, MLMs are designed to make profit for the owners/shareholders of the company, and a few individual participants at the top levels of the MLM pyramid of participants. According to the [U.S. Federal Trade Commission](#) (FTC), some MLM companies already constitute illegal pyramid schemes even by the narrower existing legislation, exploiting members of the organization.^{[15][16][17]} There have been calls in various countries to broaden existing anti-pyramid scheme legislation to include MLMs, or to enact specific anti-MLM legislation to make all MLMs illegal in parallel to pyramid schemes, as has already been done in some jurisdictions.^[citation needed]

While the legal distinction between MLMs and traditional pyramid schemes have been characterized by many authorities as merely a [legal fiction](#), jurisdictions that retain a legal distinction between MLM pyramid businesses vs illegal pyramid schemes retain said distinction on two key distinguishing features: that 1) MLMs always encompass the sale of actual products/services, while traditional illegal pyramid schemes ordinarily do not (though sometimes

they may), and 2) climbing an MLM pyramid is overwhelmingly statistically improbable (especially to its highest participant levels) but not theoretically impossible, whereas climbing a traditional illegal pyramid scheme is both statistically and theoretically impossible.

Employment law

MLM salespeople are not [employees](#) of the MLM company. They do not derive a salary/wage, nor reimbursement from the MLM business for their invested labor and expenses. Their income, if any, is derived only from the profits that are able to be generated in the MLM compensation structure.

As non-employees, participants are not protected by legal rights of [employment law](#) provisions. Instead, salespeople are typically presented by the MLM business as "independent contractors" or "business owners"; however, salespeople do not possess a [business](#) in the traditional legal sense, as they do not hold any tangible business assets or intangible business [goodwill](#) which could be sold or purchased in the sale or acquisition of a business.

Lawsuits

Companies that use MLM models for compensation have been a frequent subject of criticism and lawsuits. Legal claims against MLMs have included, among other things:

- their similarity to traditional illegal pyramid schemes
- [price fixing](#) of products or services,
- [collusion](#) and [racketeering](#) in backroom deals where secret compensation packages are created between the MLM company and a few individual participants to position them at the top of the MLM participant pyramid outside of the public compensation package framework expected to be followed by all other participants who have been set up for financial loss in their futile quests for "success"
- high initial entry costs (for marketing kit and first products),
- emphasis on recruitment of others over actual sales,
- encouraging if not requiring members to purchase and use the company's products,
- exploitation of personal relationships as both sales and recruiting targets,
- complex and exaggerated compensation schemes,
- false product claims
- the company or leading distributors making major money off participant-attended conventions, training events and materials, advertising materials, and
- [cult-like](#) techniques which some groups use to enhance their members' enthusiasm and devotion.^{[7][18]}

Direct selling and network marketing

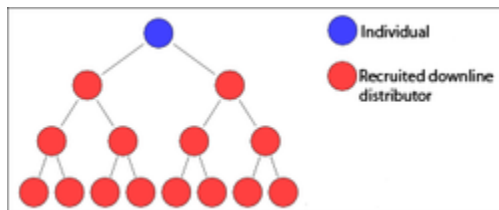
Network marketing and multi-level marketing have been described by author [Dominique Xardel](#) as being synonymous, and as methods of [direct selling](#).^[9] Other terms that are sometimes used to describe multi-level marketing include "word-of-mouth marketing", "interactive distribution", and "[relationship marketing](#)". Critics have argued that the use of different terms and "[buzzwords](#)" is an effort to distinguish multi-level marketing from illegal [Ponzi schemes](#), [chain letters](#), and consumer fraud scams.^[19] Some sources classify multi-level marketing as a form of direct selling rather than *being* direct selling.^{[20][21][22]}

The [Direct Selling Association](#) (DSA), a [lobbying group](#) for the multi-level marketing industry, reported that in 1990 twenty-five percent of members used MLM, growing to 77.3 percent in 1999.^[23] By 2009, 94.2% of DSA members were using MLM, accounting for 99.6% of sellers, and 97.1% of sales.^[24] Companies such as [Avon](#), Electrolux, Tupperware,^[25] and Kirby all originally used single level marketing to sell their goods and later introduced multi-level compensation plans.^[20] The DSA has approximately 200 members^[26] while it is estimated there are over 1,000 firms using multi-level marketing in the United States alone.^[27]

History

The origin of multi-level marketing is often disputed; but multi-level marketing style businesses existed in the 1920s,^[28] 1930s California Vitamin Company,^[29] (later named [Nutrilite](#)) or California Perfume Company (renamed as "[Avon Products](#)").^[30]

Setup



MLM [binary tree](#) structure. The blue individual will receive compensation from the sales of the downline red members.

Independent non-salaried participants, referred to as distributors (variously called "associates", "independent business owners", "independent agents", etc.), are authorized to distribute the company's products or services. They are awarded their own immediate retail profit from customers plus commission from the company, not downlines, through a multi-level marketing compensation plan, which is based upon the volume of products sold through their own sales efforts as well as that of their downline organization.

Independent distributors develop their organizations by either building an active consumer network, who buy direct from the company, or by recruiting a *downline* of independent distributors who also build a consumer network base, thereby expanding the overall organization.

The combined number of recruits from these cycles are the sales force which is referred to as the salesperson's "downline". This "downline" is the [pyramid](#) in MLM's multiple level structure of compensation.^[9]

Assuming the blue individual recruits five, and those five recruit their own five, and so on, the maximum theoretical cycles of recruits possible in the "downline" of the blue individual is 14 cycles ($5^{14} = 6.1$ billion people), after which point the total human population is exceeded.

Distributors can also earn a profit by retailing products they purchased from the company at [wholesale](#) price.

Pyramidal structure

MLMs often argue that all businesses are pyramidal in structure, with a CEO at the top, management levels beneath, and successive levels of increasingly numerous employees undearneath them.

That pyramid organizational structure of a business is then argued by MLMs to show that MLMs are no more pyramids than other business structures, and that it is unfair to paint MLMs as a type of pyramid scheme rather than a legitimate business structure.

The pyramid shape in MLMs, however, does not refer to "pyramid organizational structure," but rather, it refers to the pyramid structure of MLM's incoming revenue sources, which itself stems from its unpaid participants (i.e. its unpaid participating non-employees). This is the reason MLMs are grouped with other ordinary pyramid schemes, even where they might not be classified as such by existing law.

In ordinary businesses, though, the pyramid shape does not refer to a pyramid structure of revenue of the business, but refers to the "pyramid organizational structure" of the business' human resources (i.e. its paid employees). Revenue and income of ordinary businesses then comes from independent customers (i.e. not from participants of the business).

Income levels

Several sources have commented on the income level of specific MLMs or MLMs in general:

- [*The Times*](#): "The Government investigation claims to have revealed that just 10% of [Amway](#)'s agents in Britain make any profit, with less than one in ten selling a single item of the group's products."^[31]
- Eric Scheibeler, a high level "Emerald" Amway member: "UK Justice Norris found in 2008 that out of an IBO [Independent Business Owners] population of 33,000, 'only about 90 made sufficient incomes to cover the costs of actively building their business.' That's a 99.7 percent loss rate for investors."^[32]
- [*Newsweek*](#): based on [Mona Vie](#)'s own 2007 income disclosure statement "fewer than 1 percent qualified for commissions and of those, only 10 percent made more than \$100 a week."^[33]
- Business Students Focus on Ethics: "In the USA, the average annual income from MLM for 90% MLM members is no more than US \$5,000, which is far from being a sufficient means of making a living (San Lian Life Weekly 1998)"^[34]
- [*USA Today*](#) has had several articles:
 - "While earning potential varies by company and sales ability, [DSA](#) says the median annual income for those in direct sales is \$2,400."^[35]
 - In an October 15, 2010 article, it was stated that documents of a MLM called [Fortune Hi-Tech Marketing](#) reveal that 30 percent of its representatives make no money and that 54 percent of the remaining 70 percent only make \$93 a month, before costs. Fortune was under investigation by the Attorneys General of Texas, Kentucky, North Dakota, and North Carolina with Missouri, South Carolina, Illinois, and Florida following up complaints against the company.^[36]
 - A February 10, 2011 article stated "It can be very difficult, if not impossible, for most individuals to make a lot of money through the direct sale of products to consumers. And big money is what recruiters often allude to in their pitches."^[37]
 - "Roland Whitsell, a former business professor who spent 40 years researching and teaching the pitfalls of multilevel marketing": "You'd be hard-pressed to find

anyone making over \$1.50 an hour, (t)he primary product is opportunity. The strongest, most powerful motivational force today is false hope."^[37]

Legality and legitimacy

United States

MLM businesses operate in all 50 U.S. states. Businesses may use terms such as "affiliate marketing" or "home-based business franchising". Many [pyramid schemes](#) attempt to present themselves as legitimate MLM businesses.^[10] Some sources say that all MLMs are essentially pyramid schemes, even if they are legal.^{[7][13][14]}

The [U.S. Federal Trade Commission](#) (FTC) states: "Steer clear of multilevel marketing plans that pay commissions for recruiting new distributors. They're actually illegal pyramid schemes. Why is *pyramiding* dangerous? Because plans that pay commissions for recruiting new distributors inevitably collapse when no new distributors can be recruited. And when a plan collapses, most people—except perhaps those at the very top of the pyramid—end up empty-handed."^[38]

In a 2004 Staff Advisory letter to the Direct Selling Association, the FTC states:

Much has been made of the personal, or internal, consumption issue in recent years. In fact, the amount of internal consumption in any multi-level compensation business does not determine whether or not the FTC will consider the plan a pyramid scheme. The critical question for the FTC is whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that are not simply incidental to the purchase of the right to participate in a money-making venture.^[39]

The Federal Trade Commission warns "Not all multilevel marketing plans are legitimate. Some are pyramid schemes. It's best not to get involved in plans where the money you make is based primarily on the number of distributors you recruit and your sales to them, rather than on your sales to people outside the plan who intend to use the products."^[40]

Criticism

The Federal Trade Commission issued a decision, [In re Amway Corp.](#), in 1979 in which it indicated that multi-level marketing was not *illegal per se* in the United States. However, [Amway](#) was found guilty of [price fixing](#) (by effectively requiring "independent" distributors to sell at the same fixed price) and making exaggerated income claims.^{[41][42]}

The FTC advises that multi-level marketing organizations with greater incentives for recruitment than product sales are to be viewed skeptically. The FTC also warns that the practice of getting commissions from recruiting new members is outlawed in most states as "pyramiding".^[43]

In April 2006, the FTC proposed a Business Opportunity Rule intended to require all sellers of business opportunities—including MLMs—to provide enough information to enable prospective buyers/participants to make an informed decision about acquiring/joining a business venture with information disclosed about the average likelihood of monetary profitability (and the extent of monetary profitability, if any) of acquiring/joining the business venture. In March 2008, however, the FTC removed "Network Marketing" (i.e. MLM) companies from the proposed Business Opportunity Rule, thus leaving MLM participants without the ability to make an

informed choice of entering or not entering MLMs based on the disclosed likelihood of success and profitability:

The revised proposal, however, would not reach multi-level marketing companies or certain companies that may have been swept inadvertently into scope of the April 2006 proposal.^[44]

Walter J. Carl stated in a 2004 *Western Journal of Communication* article that "MLM organizations have been described by some as cults (Butterfield, 1985),^[45] pyramid schemes (Fitzpatrick & Reynolds, 1997),^[46] or organizations rife with misleading, deceptive, and unethical behavior (Carter, 1999),^[47] such as the questionable use of evangelical discourse to promote the business (Höpfl & Maddrell, 1996),^[48] and the exploitation of personal relationships for financial gain (Fitzpatrick & Reynolds, 1997)".^{[46][49]} In China, volunteers working to rescue people from the schemes have been physically attacked.^[50]

MLMs are also criticized for being unable to fulfill their promises for the majority of participants due to basic conflicts with Western cultural norms.^[51] There are even claims that the success rate for breaking even or even making money are far worse than other types of businesses:^{[52][53][54]} "The vast majority of MLMs are recruiting MLMs, in which participants must recruit aggressively to profit. Based on available data from the companies themselves, the loss rate for recruiting MLMs is approximately 99.9%; i.e., 99.9% of participants lose money after subtracting all expenses, including purchases from the company."^[52] In part, this is because encouraging recruits to further "recruit people to compete with [them]"^[7] leads to "market saturation."^[18] It has also been claimed "(b)y its very nature, MLM is completely devoid of any scientific foundations."^[55]

Because of the encouraging of recruits to further recruit their competitors, some people have even gone so far as to say at best modern MLMs are nothing more than legalized [pyramid schemes](#)^{[7][13][14]} with one stating "Multi-level marketing companies have become an accepted and legally sanctioned form of pyramid scheme in the United States"^[13] while another states "Multi-Level Marketing, a form of Pyramid Scheme, is not necessarily fraudulent."^[14]

In October 2010 it was reported that multilevel marketing companies were being investigated by a number of state attorneys general amid allegations that salespeople were primarily paid for recruiting and that more recent recruits cannot earn anything near what early entrants do.^[56]

Industry critic [Robert L. FitzPatrick](#) has called multi-level marketing "the Main Street bubble" that will eventually burst.^[57]

China

Multi-level marketing ([simplified Chinese](#): 传销; [traditional Chinese](#): 傳銷; [pinyin](#): *chuán xiāo*) was first introduced to [China](#) by American, Taiwanese, and Japanese companies following the [Chinese economic reform](#) of 1978. This rise in multi-level marketing's popularity coincided with economic uncertainty and a new shift towards individual consumerism. Multi-level marketing was banned on [the mainland](#) by the government in 1998, citing social, economic, and taxation issues.^[58] Further regulation "Prohibition of Chuanxiao" (where MLM is a type of Chuanxiao, Chinese name of the regulation is 《禁止传销条例》), was enacted in 2005, clause 3 of Chapter 2 of the regulation states having downlines is illegal (original text from the regulation '组织者或者经营者通过发展人员, 要求被发展人员发展其他人员加入, 形成上下线关系, 并以下线的销售业绩为依据计算和给付上线报酬, 牟取非法利益的。').^[12] O'Regan wrote

'With this regulation China makes clear that while Direct Sales is permitted in the mainland, Multi-Level Marketing is not'.^[111]

MLM companies have been trying to find ways around China's prohibitions, or have been developing other methods, such as direct sales, to take their products to China through retail operations. The Direct Sales Regulations limit direct selling to cosmetics, health food, sanitary products, bodybuilding equipment and kitchen utensils. And the Regulations require Chinese or foreign companies ("FIEs") who intend to engage into direct sale business in mainland China to apply for and obtain direct selling license from the Ministry of Commerce ("MOFCOM").^[59] In 2016, there are 73 companies, including domestic and foreign companies, have obtained the direct selling license.^[60] Some multi-level marketing sellers have circumvented this ban by establishing addresses and bank accounts in [Hong Kong](#), where the practice is legal, while selling and recruiting on the mainland.^{[11][61]}

It was not until August 23, 2005 that the State Council promulgated rules that dealt specifically with direct sale operation- Administration of Direct Sales (entered into effect on 1 December 2005) and the Regulations for the Prohibition of chuanxiao (entered into effect on 1 November 2005). When direct selling is allowed, it will only be permitted under the most stringent requirements, in order to ensure the operations are not pyramid schemes, MLM, or fly-by-night operations.

See also

- [List of multi-level marketing companies](#)

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