

# **Seven Common Misconceptions About Multilevel Marketing & Pyramid Schemes**

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## **1) Multilevel marketing (MLM) distributors typically earn company compensation based on their product sales.**

False. Multilevel marketing companies typically compensate participants based on personal purchases and purchases made by distributors in their downline. With company compensation triggered by distributor purchases and not retail sales, the MLM model is actually quite different from traditional direct selling. In addition to purchase-driven company compensation, MLM companies point to the possibility of distributors generating income by selling products to non-distributors (e.g., friends, neighbors, etc.) and in some cases to other distributors. MLM companies that encourage or even require such sales may then fail to document the amount of income earned from these product sales. According to previous court cases, a lack of significant product sales to non-distributors can be one possible indicator of a pyramid scheme.

## **2) MLM companies that are actually pyramid schemes have either upfront distributor fees or sell “sham” products (i.e., products that do not perform as promised).**

False. Pyramid schemes come in all shapes and sizes. Some have fees; some do not. Some have sham products; some have real products; some have no products at all. Products sold by MLM companies found to be pyramid schemes have varied from providing proprietary products available only from the company to branded products from national manufacturers. In all cases, however, pyramid schemes compensate participants primarily from purchases and/or fees related to recruiting new distributors and not primarily for product sales to non-distributor customers.

## **3) Federal and/or state regulators will quickly take action against any MLM company thought to be a pyramid scheme.**

False. In 2013 a court closed Fortune Hi-Tech Marketing (FHTM) for operating a pyramid scheme, based on Federal Trade Commission analysis. FHTM had operated for ten years and had two former state Attorneys General as advisors help reinforce the message of legality. Other prosecutions of FTC-alleged pyramid schemes, while posing as proper MLMs, have also occurred after operating for many years; e.g., FTC v. Equinox International (1999), an ostensible MLM firm that agreed to a settlement to close its doors (including any international operations) and pay \$40 M in consumer redress after operating for at least 10 years. Part of the problem is in gathering sufficient evidence about how the company actually makes money. In addition, state and federal regulators have limited budgets for stopping all consumer frauds. While the most obvious non-product pyramid schemes may be closed quickly, product-based pyramid schemes may take many years to identify.

## **4) Two MLM distributors working equally hard in the same company will have about the same probability of success (i.e., hard work = success in an MLM company).**

False. Hard work helps in every endeavor. However, the underlying economics of the MLM structures means that two distributors working equally hard, participating in the same training,

and investing equally in products and support can face very different competitive environments. One may have dozens of nearby distributors also selling the exact product and business opportunity while the other may have few. As a result, two distributors working equally hard will not have the same chance for success. It is this difference that makes the path to success in an MLM company impossible for a new recruit to identify. Some upline distributors claim that purchasing leads or attending seminars will directly increase a distributor's chance of success, adding value to his or her hard work. Unfortunately, the profit made by upline distributors from selling leads and offering seminars raises questions about their motivations. It is clear that even an MLM distributor who tries and fails can generate profit for upline distributors.

**5) An MLM company with these policies cannot be a pyramid scheme: 1) a 10-customer or retail sales rule, 2) a 70% rule, and 3) a product return policy.**

False. In the late 1970s Amway successfully defended itself against a pyramid scheme charge by pointing to three company policies intended to ensure retail sales, prevent inventory loading, and allow product returns. Since then many companies have adopted similar policies. However, MLM companies have not adopted uniform policies; actual policies vary greatly. These policies can be ineffective, unenforced, and even unenforceable; thus they provide no guarantees against an MLM company actually being a pyramid scheme.

**6) Claims made by current MLM distributors regarding potential earnings and product performance are bound to be true because false claims are prohibited by law.**

False. Of course, making any false or misleading statements in trade or commerce, including about a product or earnings in a business opportunity, is illegal and if documented, can bring enforcement litigation. Messages between a distributor and potential recruits, however, are less easy to document and have a lower chance of being noticed. In 1951 the Food and Drug Administration obtained an injunction against Nutrilite, the first modern MLM company "prohibiting 15,000 door-to-door salesmen from making 'extravagant therapeutic claims'." In 2012 Herbalife, a large public MLM company warned, "there can be no assurance that our distributors will participate in our marketing strategies or plans, accept our introduction of new products, or comply with our distributor policies and procedures." Because of the large number of distributors it seems that MLM companies cannot fully trust, and even seek to take distance from, what their distributors may be saying.

**7) If a multilevel marketing company is actually a pyramid scheme plenty of victims will come forward to complain.**

False. Research by the Federal Trade Commission shows that among victims of the ten most common consumer frauds, pyramid scheme victims are by far the least likely to complain. Because failure may be incorrectly presented as failing to work hard (see above), victims of pyramid schemes may blame themselves. Or, they may be embarrassed for being snookered into the pyramid scheme fraud in the first place. Either way, pyramid scheme victims often simply go away without complaining and without sharing their story with others.