

MULTILEVEL MARKETING VERSUS PYRAMID SCHEMES

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ABSTRACT

With the passage of time, new concepts and ideas emerge in every sphere of life and the field of marketing is no exception to it. Traditionally marketing was considered to be the work of professional, full time marketers but there is a new concept called “Multi Level Marketing” which is making marketing every body’s cup of tea. Many people, who want to work from home or work part time, take a look at MLM as an option. Anybody who has the strong determination, ability to work hard and good communication skills can jump into this system. Good salesmanship and team building ability are the two main qualities required in this system. As no system is free from defects so is MLM. It is often criticized by people on various grounds. Often it is charged with similarity to pyramid schemes. The present paper deals with this problem and attempts to differentiate MLM from Pyramid schemes and also helping the interested persons to choose legitimate MLM companies to work with.

Keywords: Multilevel Marketing, Pyramid Schemes

INTRODUCTION

Think of a person ringing your doorbell. You are busy in your routine schedule. You get up to open the door and find a person on your doorsteps with a product or some brochures in his hands and tries to sell you his product. You get irritated and rarely believe him. This is an example of direct selling. “Direct selling is a mode of selling whereby a company sells its products directly to consumers without a long chain of intermediaries.”

Multi Level marketing has its origin from Direct Selling. Traditionally Direct Selling included single level marketing only hereby either salaried persons or commission based agents used to sell the products directly to consumers. Multi Level marketing is an extended version of single level marketing. Now take the earlier example once again. If the person at your doorsteps is one of your relatives, friends or any other person known to you instead of an entirely unknown person. This is the basic idea of multi level marketing structure. You will welcome him, offer him a seat and most probably you will believe his claims regarding products. This is the reason it is also called as “Referrals Marketing.” Now we talk about the “Multi Levels” of this system. This is a system whereby initially some persons join hands with the company. These persons are known by different names in different companies. These are known as agents, independent agents, distributors, Independent business owners, associates, consultants, product consultants, sales consultants, dealers or franchise owners etc. and many other names. Now these independent agents have two major tasks to do. The

first is to sell the products/services manufactured/provided by the company. These agents get a commission/Profit on the products they sell. The second important task is to build a team. A person alone can't think of make huge profits and also he has limited contacts in the society. For this purpose they need a team to sell the products. Now there arises questions why to build the team? What is the prime agent's motive? What's his profit? Now here comes the answer. Along with getting commission on his own sale he gets a particular commission on the sale of his team members. This is the reason that to achieve higher levels of income he introduces other agents to the company who are collectively known as his down line organization. Now this process goes on and on. Down line members bring more members making it a network of members. Not only this, persons achieving particular targets gets additional incentives both financial and non financial depending upon the incentive plans of the company.

In this way there becomes a network of members and in this network there are various levels. That's why it is called Multi Level Marketing or Network Marketing or Referrals Marketing.

After above discussion it is necessary to reach at a short and precise definition of Multi Level Marketing.

According to Wikipedia

“Multi Level marketing (MLM), is a term that describes a structure designed to create a marketing and sales force by compensating promoters of company products not only for sales they personally generate, but also for the sales of other promoters they introduce to the company, creating a downline of distributors and a hierarchy of multiple levels of compensation.”

History of Multi Level Marketing

MLM began life in 1886, (as cited in article “The New Multi Level Marketing Model” by Pareena Kawatra in Business today, September 22 – October 6, 1996), when door to door salesman David H. Mc Connel founded the California perfume company and set up a sales team using the concept. His first sales lady, Mrs. P.F.E. Albee, not only vended the little Dot Perfume Set, but also recruited other women to her team. McConnel's next Company, Avon, Set up in 1928, followed the MLM System faithfully and continuously using this till date.

It is also believed that the first formal MLM Plan was introduced in 1945 (as cited in Wikipedia) by the California Vitamin Company which was renamed ‘Nutrilite’. In 1959, Rich Devos and Jay Van Andel – distributors with the same company broke away to set up the MLM giant Amway. It was not till the advent of Glen W. Turner Enterprises in the US in 1967, however, that MLM came under the scrutiny of law.

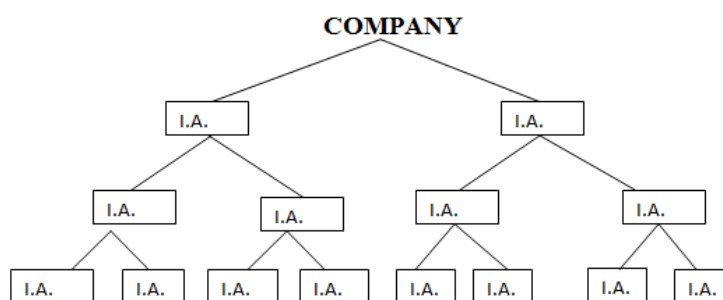
The crackdown came in 1975 when the Federal Trade Commission attacked MLM, including 30 companies, one of them being Amway. However, in a landmark decision, the court ruled that Amway was not an illegal pyramid and that its method of distribution was legal. While Avon retains its conservative image of being a solid brand, the controversy surrounding Amway never really died down.

With the passage of time many new companies kept coming in the market with MLM structure and today we have a large number of companies which have adopted MLM as their marketing plan.

Structure

Let us understand the structure of Multi Level Marketing. First of all there is a company which wants to distribute its products through MLM System. Then company organizes initial meetings and seminars and out of these, there is generated the first level of independent agents. These agents will sell the products of company and will also introduce more members to the company. These new agents will be known as downline organization of the prime agent.

This process shall go on and on. In the process many members leave the network and other new members may join the network. Ultimately the basis structure of MLM looks like:



Note: I.A. = Independent Agents

STATEMENT OF PROBLEM

MLM is often criticized for similarity with illegal pyramid schemes. Pyramid schemes are such schemes wherein the prime motive of the members is to being new members to their team than sale of products. The upline of members get benefitted with the entry of new member as they have share in the entry fee of the member. In this way members on the top get benefitted but members at lower orders are there to lose money. Critics blame MLMs to be similar to these illegal pyramid schemes

OBJECTIVES

The paper will attempt

- To introduce the concept of Multi Level Marketing.
- To introduce the concept of pyramid schemes.
- To Differentiate Multilevel Marketing from Pyramid Schemes.
- To find out the basis to choose a legitimate MLM plan.

REVIEW OF LITERATURE

Lowell E. Stockwill(1985) in his study “Multilevel Franchise or Pyramid Scheme” , compared MLM with the pyramid schemes and found out that people get easily attracted towards these direct selling plans because of its’ various advantages that are told to them. He has also given various grounds on which MLMs become similar to these illegal pyramid schemes. He has told that absence of strong legislation makes the condition worse. So people should think logically before joining any such system. Another study “Ethical issues connected with Multilevel Marketing Schemes” by Daryl Koehn(2001) states that MLMs

bring various challenges because of their similarities to the pyramid schemes. He has given the features of a pyramid scheme as more stress on recruiting more members rather selling the product, require high entry fee and pressurize the members to buy products for their own consumption. He also argued that it is possible for MLM to become illegal unethical recruitment based system. Wendy Harris(2004) in his article "Network Marketing or Pyramid Scheme" illustrated experiences of many persons to warn general public to beware of the hype created by the MLM people. He used the term "overinflated earnings claims" which are used to attract the prospects in this system. James A. Muncy(2004) in his study "Ethical Issues In Multilevel Marketing: Is It A Legitimate Business Or Just Another Pyramid Scheme?" stated that marketing students are generally contacted by MLM agents to join the system. These students then ask their marketing professors regarding the system. He has developed five questions which a student should ask before joining such system. These questions are (i) How is the money being made? (ii) Is the product legitimate? (iii) How much does it cost to be involved? (iv) How much work is to be done? And (v) How long has the company been around? The answers to these questions can guide them for future.

RESEARCH METHODOLOGY

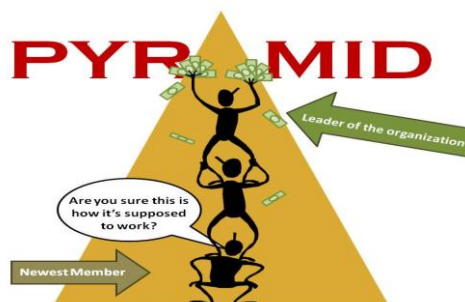
The objectives will be achieved with the help of content analysis. The information has been obtained with the help of review of literature, visiting the websites related to direct selling and informal talks with the independent agents of MLM system. The study is descriptive in nature.

FINDINGS

The meaning of multilevel marketing has been described above in detail. Multilevel marketing is not marketing in real sense. It is a system of organizing and compensating the sales force of the company. It may be explained as an organizational structure in which members will be compensated in two ways. First they will receive commission on the product they sell and also they will receive the commission on the products sold by their downline. As we have explained above that MLM companies are generally compared with illegal pyramid schemes. So first we should know the meaning of pyramid schemes.

Meaning of Pyramid Schemes

Pyramid schemes are basically frauds. In these schemes the stress is given on bringing more members in the system rather than selling the products. Either there is no product or the product is of no value or sometimes the product is highly overpriced. The compensation of the members depends upon the new recruits. In this system, it is considered that there may become endless chain of recruits. But ultimately market saturation happens and newest recruits remain losers. The members on the top of pyramid are the only gainers.



Another thing is that in pyramid schemes the start up cost is really very high. The money brought by the newest member is distributed among the upline agents and in return he gets no real marketable products. In this way the members are pressurized to purchase the products and stock piling is done. Ultimately pyramids are fraudulent, illegal and losers.

Differentiating Between Illegal Pyramid Schemes and Legitimate Multilevel Marketing

The legitimate MLM can easily be differentiated from illegal pyramid schemes on the following basis:

- Legal MLM system would offer you a genuine business opportunity for selling products which are of high quality and stress is on consumer satisfaction. Consumers are given chance to return the goods and get refund if they are not satisfied; whereas in pyramid schemes the stress is on bringing new recruits rather than sale of products.
- Legal MLM system will never encourage stockpiling rather they stress on first take the orders from consumers and then place the orders. They also provide a chance to their recruits to leave the system when they wish and also they can return the unused inventory to the company and can receive 80% to 100% of their cost. In pyramid schemes overstocking is a normal practice and in the end the recruits are left with a kind of stock which they can neither sell in the market nor return to the company.
- Legal MLMs provide opportunity of business at minimum cost whereas the start up cost of pyramid schemes is very high.
- Legal MLMs' compensation plan promotes the sale of the products. On the other hand compensation plan of pyramids stresses upon bringing new members.

Choice of Legitimate MLM Plan

Direct selling through multilevel compensation brings many benefits to the marketplace. It provides opportunities to various individuals who might be ignored or under-utilized in the employment market. It is a fairly simple and economic way for individuals to learn basic business and management skills. It offers a flexible schedule and means to add income. Additionally, it allows businesses with unique or innovative products or services to bring them to the market without the huge expense of mass media advertising, and without having to compete for shelf space in retail stores. It is a popular method of retail distribution that has a strong presence in almost every region of the world. Due to so many benefits it is obvious that people will get attracted towards this system. But they should take every care in selecting the MLM company for themselves. Following are some points which needs to be considered while deciding to become a part of the MLM network which are given by World Federation Of Direct Selling Associations(WFDSA):

- **Identify A Company And Product That Appeal To You**

First of all one should consider the company and the product that appeals to himself. The persons should judge the products that if they themselves can use the products only then they can convince others.

- **Take Your Time Deciding For Joining**

A legitimate opportunity won't disappear overnight. Take your time in deciding whether to join the network or not. Never take decision under pressure of any kind.

- **Ask Questions**

It is healthy practice to ask questions about the company, its leadership, the products or services, start-up fees, realistic costs of doing business, average earnings of distributors, return policies, and anything else you're concerned about. If the company is legitimate then it shall satisfy you by giving answer of your each and every question.

- **Get Copies Of All Company Literature**

Collect all the company literature available and also read it carefully. It shall give you insight of company's vision, goals, history, compensation plan and products etc.

- **Consult With Others Who Have Had Experiences With The Company And Its Products**

You should be sure if the products or services are actually being sold to consumers. You can ask other experienced persons or consumers also.

- **Investigate And Verify All Information**

You should investigate and verify all information as sometimes official looking documents are also not real.

- **Need Help Evaluating A Company?**

If you need help of any kind you can contact to the direct selling association of your country. Indian Direct Selling Association (IDSA) works in India. In the same way such associations work in different countries. List of all direct selling associations is given on WFDSA's official website.

- **Don't Make A Costly Mistake!**

Always keep in mind that no legitimate MLM requires high start up cost. A lot of persons have lost their money in the ponzy schemes. So beware of expensive plans.

CONCLUSION

Multilevel Marketing presents an attractive business opportunity. But people must remember that nobody becomes rich overnight. A lot of hard work is required to set up and maintain a team. If any scheme is promising riches overnight then don't take the decision in a hurry and over enthusiasm. It may be a wolf in the sheep's clothing. Relax and take your time in evaluating the plan. You should be sure before joining a network. It is well known to all, "Better Be Sure Than Sorry."

NOTE

Abbreviation Used: MLM = Multilevel Marketing

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