

Managing Multilevel Marketing as a Legitimate Organizational Practice

¹John Mylonakis and ²Alketas Malioukis

¹10 Nikiforou Street, Glyfada, 166 75, Athens, Greece

²28 Ithakis Street, Pallini, 153 44, Athens, Greece

Abstract: The rapid growth of Multilevel Marketing (MLM), or network marketing industry, in the last decade has made itself an attention-gathering star in the retailing industry. Hoping to reap the merits and benefits of this unique marketing method, more and more companies who marketed their products and services through traditional market channels previously are now testing the possibility of employing the direct selling formula. Nevertheless, influenced by numerous factors, not every product or service has the equal chance for realizing its market potential in the area of direct selling. The paradigm of this study raises the question of how a business, in which almost none of its sales representatives earn a profit and almost none has a sustainable retail customer base, could be called direct selling company. Indeed, how such an enterprise could be considered a legitimate business at all?

Key words: Multilevel marketing, services, distribution, retail channels, sales

INTRODUCTION

Multilevel Marketing (MLM) is a marketing activity in which a company uses independent sales distributors who bear the responsibilities for selling the products/services, recruiting new members and are entitled to economic rewards, in building its customer base and expanding market reach. In a market place where many conventional retailing channels facing challenges imposed by the development of modern technologies, the market performance of the MLM industry seemed to be unaffected and has been making envious progress.

However, facing with mounting competitive pressure within the industry, issues concerning how to develop the right product mix to meet the needs of the changing consumer tastes and lifestyles has become a topic for both MLM practitioners and the retailing industry as whole (Brodie *et al.*, 1997).

DEFINING MULTILEVEL MARKETING (MLM)

Multilevel Marketing (MLM) is a way of distributing products or services in which the distributors earn income from their own retail sales and from retail sales made by their direct and indirect recruits. As a form of direct selling, MLM involves non-store retailing based on face-to-face communications between a selling representative and a potential buyer (Tai, 2000). Multilevel marketing, also known as network or matrix marketing is a way of selling goods or services through distributors. This typically promise that if you sign up as a distributor,

you will receive commissions-for both your sales of the goods or services and those of other people you recruit to join the distributors. Multilevel Marketing usually promise to pay commissions through two or more levels of recruits, known as the distributor's down line. Although MLM is estimated to account for less than 1% of retail marketing in Greece, it has dramatically increased in size and expanded internationally during the 1990s.

The main motivation for resellers in a Multilevel Marketing organization lies in the compensation gained from sales to customers and from sales of resellers' recruited (Chuang, 1993). For example, the compensation could be made up as follows: Person B earns a 30% retail margin on direct retail sales (e.g., to customers, as well as 15% on retail sales made by his or her immediate resellers/recruits (e.g., B1) on retail sales made by B1's retail sales and 10% of retail sales made by any recruit of the distributor's recruits (e.g., sales of B1A, B1B and B1C assuming them to be resellers) (Fig. 1).

In this study, the marketing companies have been able to increase the number of salesmen to reach millions in number (Amway, 2004, a MLM company, reports to have 3.6 million independent distributors in 80 countries and territories selling 450 products for the annual sum of 4.5 billion euros). Typical products sold by Multilevel Marketing organizations have included a number of small physical items with sales prices ranging from tens to hundreds of euros, including home technology, homecare, nutritional supplements and personal care. However, clearly the transaction costs of a typical Multilevel Marketing organization exceed the resale margins

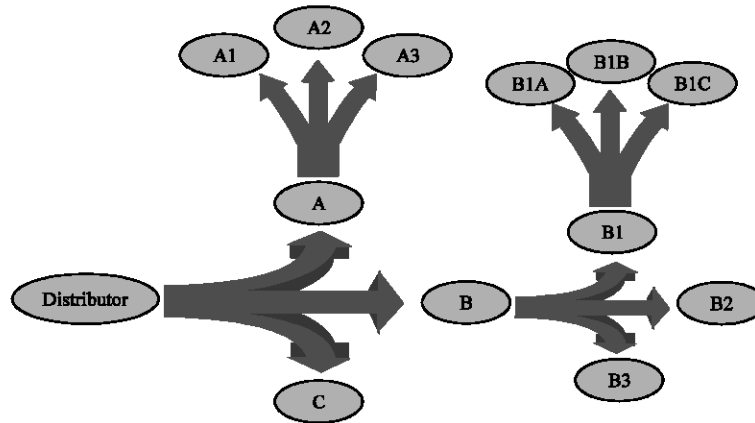


Fig. 1: Flow of goods in Multilevel Marketing through a network (tree) of distributors. Persons/distributors A, B and C purchase products on stock from Distributor and sell them to their clients (A1, A2 and A3) and their resellers (B1, B2 and B3) which can further have their own resellers (B1A, B1B and B1C)

available for sales of a single piece of music and form a major portion of the total cost of a movie (Pasi *et al.*, 2004).

Multilevel marketing as a business model and ways it works: Multilevel Marketing is a specialized business model. It differs significantly from traditional direct selling in its unique and characteristic policy of authorizing every active sales representative to recruit others and to earn override commissions from the purchases of generations of recruits in a multi-tiered chain. This use of the endless chain of recruiting is the main point of controversy. It is the characteristic that invites the financial abuse and deception (Cadeaux, 1997). The override commissions paid directly by the company to recruiters are the primary source for the promised incomes in MLM, while retail sales profits are the primary source of income in traditional direct selling.

MLM companies in most points do not differ from the rest companies that manufacture or distribute products. The basic difference is in the ways which MLM companies advertise and distribute their products or services (Yo, 1990).

Instead of making advertising and promotional campaigns and have their own personnel of sales (employees) MLM companies pay independent distributors in order to sale their products. Their sales are based on the personal constitution and support of the MLM distributor.

MLMs study by geometric expansion, where you get ten to sponsor ten to sponsor ten and so on. This is usually shown as an expanding matrix (just don't say pyramid) with corresponding kick-backs at various levels.

- Level 1: 5 people
- Level 2: 25 people
- Level 3: 125 people
- Level 4: 625 people
- Level 5: 3.125 people
- Total: 3.905 people

According to the above example the MLM distributor does not need to fill up all 5 levels by his own. It is enough only to register 5 individuals. When these 5 register other 5 individuals, the second level in the MLM table fills with 25 distributors. When these 25 register 5 each one, the third level fills with 125 individuals and so on.

The MLM management chain is not the same as management structures used by traditional sales companies. Traditional direct selling companies can organize entire countries with four levels of managers overseeing a direct sales force that retails directly to the consuming public or to business end-users (Peterson and Wotruba, 1996). In MLM companies, the number of levels expands infinitely as upper levels are awarded bonuses on the purchase volumes of extended generations of 12-level chains that have broken away when they reach purchase-volume thresholds. In this way, many MLMs function as endless chains.

The multiple levels are each paid some commission on each purchase made by new recruits. Usually between 40-60% of the price paid by the new recruit is redistributed to the recruiters above the latest entry level. In many cases, the total amount of the wholesale price that is paid to the up line exceeds the maximum gross profit the new recruit could earn if he/she were to retail the product at full price.

MLMs grow by exploiting people's relationships. If you are going to be in an MLM, you swallow hard and accept this as part of building your business. This is networking. But to those not in the MLM, it seems as if friendship is merely a pretext for phoniness, friendliness is suspected as prospecting and so on. There is no middle ground here, try as you might. While this is the most difficult point to make, it is perhaps the most important (Ronchetto *et al.*, 1989). Anyone who has any experience with an MLM has strong feelings, either for or against and this is the problem. Polarization runs deep.

MLM companies seek to obscure their devastating failure rates by disclosing the number only of active participants and limiting the income figures to a one-year or even shorter time frame, thus concealing the factor of the ongoing and mounting losses of new investors. Most MLMs do not reveal any data at all on actual average incomes (Fitzpatrick, 2004).

The business model and business practices of most Multilevel Marketing companies directly cause the financial losses suffered by millions of consumers, not normal competitive factors or the levels of efforts or talents of the participants.

MLM companies have numerous ways to obscure the fact that most are non-retailing operations disguised as direct selling companies:

- Some MLM companies calculate total purchases of sales representatives and then project an average retail profit without verifying if any products are actually retailed or not, what price they were resold for or whom they were sold to. While retailing to consumers is publicized and claimed, internally the companies' pay plans are based entirely upon wholesaling only to the distributor recruits. Whether any retail sales ever occur or not, the up line recruiters are paid rebates only on the down line's wholesale purchases, never on retail pricing charged to the end-user.
- Some companies claim they require retailing by their distributors, but no systematic method is used to audit retailing activity. That a company would have to require selling by its salespeople reveals the inherent flaw in the MLM model and its tendency toward operating as a pyramid recruitment scheme.
- Some MLM companies actually advertise their total sales volume based on unfounded retail projections, even reporting these mythical numbers to the Securities and Exchange (Chang, 1993).

The proposals of this study raise the question of how a business in which almost none of its sales representatives earn a profit and almost none has a

sustainable retail customer base could be called direct selling. Indeed, how such an enterprise could be considered a legitimate business at all?

LEGITIMACY OF MULTILEVEL MARKETING COMPANIES

The claim by Multilevel Marketing (MLM) companies of offering consumers a viable part time income or an extraordinary income greater than most other businesses or occupations is their hallmark attraction. It is also their greatest defence against persistent charges of pyramid scheme fraud, mind control and deceptive promotions. The question is whether MLM is a social and financial blight or a benefit to consumers. Legitimacy of this business ultimately hinges on the truthfulness or falsehood of its income claims. It is a question that affects the fate and fortune of hundred people every year in many countries (Hassan, 1990).

Consumers are subjected to barrages of personal testimonials and success stories. Multilevel marketing employs a seemingly indecipherable language to explain its trademark compensation plans and business model that permit unlimited authorization of sales representatives and that pay rebates based on purchases by new recruits who are recruited by the earlier recruits in an endless chain.

Gross deception is necessarily employed in order to lure large numbers of consumers into programs where they will suffer their pre-determined loss. If the truth were known and understood, few consumers would willingly join. Other enterprises such as gambling casinos and lotteries also are based on a large number of consumers losing as a means of rewarding a few winners. These enterprises are strictly regulated and the odds for success are fully disclosed.

The inevitability of losses is clearly stated and well understood. The expenditure of money is treated as entertainment. No one would seriously characterize gambling or playing the lotteries as viable income opportunities or career choices for consumers (FitzPatrick, 2005).

Moreover, unlike lotteries and casinos where success is based on random rolls of the dice or picking of numbers and each participant has an equal chance, success in MLM is based on positioning and timing. Only the top positions-usually those who joined early or organized the scheme-can gain a profit and only a tiny number can ever be at the top. The winners already occupy the positions that are guaranteed of success each time that a new participant makes an investment. The losers-those who are the latest to join the scheme-have virtually no chance to replace those already positioned at the top.

Yet, even using the MLM industry's own restrictive method of accounting, analysis of available data reveals that more than 99% of all active consumers who invest money and time in Multilevel Marketing never earn a profit. Some lose hundreds, others thousands of dollars. And still others are drawn into financial ruin gripped by the myth, which the MLM industry has carefully cultivated, that the Multilevel Marketing business offers the best opportunity for earning a living and becoming wealthy. The massive consumer losses are the direct result of the MLM industry's concerted efforts to withhold or obscure vital financial and historical income data from the investors who buy into the business as sales representatives (Vander Nat and Keep, 2002). This withholding of data is compounded by large-scale disinformation campaigns in which the business is characterized as a lucrative income opportunity and a sustainable income source for the average participant. Most of the MLM companies hold huge rallies where attendees are aroused to a frenzy of hope and expectation about the wealth and freedom they are told they will achieve in the business.

Blaming the victims: Even as millions of consumers are solicited into MLM and then quit after losing money, most do not understand why they lost. They are shown the luxurious lifestyles of the top promoters and are told that anyone can do it. The promoters convince them that they personally failed and that it was their own fault. Most have no idea of the sheer scale of people joining, losing and then quitting. They are led to believe that they are unusual in their failure.

Consequently, they not only do not complain to the government authorities but they do not even warn friends or relatives to stay out of MLM. Shame and disappointment are covered up with silence. The recruitment program continues largely unabated. As has been previously illustrated, the massive failure rates among those who invest in MLMs have almost nothing to do with the individual recruit (Dean, 2004). These multi-billion-dollar consumer losses are due to the pyramid business model. Retailing is unfeasible and the recruitment-based income plan is designed so that most will lose. It cannot be otherwise. For a few to win, basic mathematics requires all others to lose. Anyone cannot do it. The endless chain schemes do not, of course, go on forever. Nor do they continue until they quickly exhaust all possible new recruits. While the schemes are structured as endless chains and make promises to new recruits as if they were limitless and could fulfil the promise of success to all, in practice, the chain keeps

breaking at the bottom and being repaired. Large-scale failure is, in fact, necessary. If most did not quit, but continued to recruit, the earth would soon be entirely filled with MLM distributors in a very short period of time. The way the mathematical limitation works itself out is in the pattern of dropouts. Non-retailing MLMs do not fully or quickly saturate areas with members because most people quit within a year. All such schemes experience a 50-75% annual dropout rate. Dropouts thwart the recruitment process at the lower levels. The people trying to build the down line are always dependent on others below to duplicate the process. When their new recruits become discouraged and drop out, the rebuilding process must restart (Vander Nat and Keep, 2002). And while the hopefuls engage in this constant rebuilding effort, they are also continuously paying money to the scheme and its organizers-in product purchases, training fees and marketing costs, as well as, incurring other normal business expenses. With its ongoing operation, continuous enrolment of excited new recruits and public displays of wealth and success by the organizers, the organization appears to the uninformed as viable, stable and successful.

Most schemes can go on for many years by successfully recruiting new people to refill the bottom ranks, which become open as past recruits quit the business in failure. Eventually, they must move to new markets, usually in other countries and some also use the ploy of changing their names in order to continue deceptive recruiting.

CONCLUSION

Over the last fifteen years, the Multilevel Marketing industry has successfully established itself as a dominant marketing channel. In an attempt to overcome the pitfalls and limitations of the conventional marketing channels, more and more companies experiment the possibility of combining their offerings with the direct selling formula. Several consumer products such as credit cards, computer software packages and health checkups have been put into direct selling practices. Even though it is still too early to define the boundaries of adopting MLM strategies in a such wide range, it is no doubt that a genuine market focus and service-oriented devotion will always be the most essential piece of a successful product strategy.

Even though MLM has proved to be a successful marketing practice, its legitimacy is still controversial. We all, as consumers and potential distributors (or victims) in a MLM company must be cautious of plans that claim we will make money through continued growth of our down

line-the commissions on sales made by new distributors we recruit-rather than through sales of products we make our self. And finally we must beware of plans that claim to sell miracle products or promise enormous earnings. Just because a promoter of a plan makes a claim doesn't mean it's true! Ask the promoter of the plan to substantiate claims with hard evidence.

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