

## What is MLM system

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*The multilevel marketing (MLM) field grows, and its member companies multiply. Solicitations to join seem to be everywhere. Its promoters would like you to believe that it is the wave of the future, a business model that is gaining momentum, growing in acceptance and legitimacy, and will eventually replace most other forms of marketing. Many people are led to believe that success will come to anyone who believes in the system and adheres to its methods.*

**Key words:** multilevel marketing, network marketing, compensation plans, pyramid,

#### Overview

In a typical multi-level marketing or network marketing arrangement, individuals associate with a parent company as an independent contractor or franchisee and are compensated based on their sales of products or service, as well as the sales achieved by those they bring into the business.

In a legitimate MLM company, commissions are earned only on sales of the company's products or services. No

money may be earned from recruiting alone („sign-up fees"). One must analyze the compensation plan to determine whether participants are paid from actual sales to customers and not from money received from new recruits. If participants are paid primarily from money received from new recruits, then the company is an illegal pyramid or Ponzi scheme.

Multi-Level Marketing (MLM) businesses function by recruiting

salespersons to sell a product and offer additional bonus or sales commission if they recruit more salespersons as their „downline“. New joiners may be required to pay for their own training / marketing materials, or to buy a significant amount of inventory. Thus it is possible that an MLM may be considered a pyramid scheme if salespersons are more concerned with recruiting a downline or if they must buy more product than they are ever likely to sell.

Some less legitimate companies produce revenues primarily by attracting new participants with the hope of reward and selling them products or services of dubious value at inflated prices, as opposed to selling products or services consumers would purchase at the given price without regard to the opportunity attached. One must evaluate the products or services and determine if a significant percentage of consumers would continue to purchase them if the participants do not make money from the underlying opportunity. If the products or services have dubious value or if the participants must purchase excessive quantities without reasonable intent to use or resell said items, then the company is likely a thinly veiled illegal pyramid scheme.

Multi-level marketing has a recognized image problem due to the fact that it is often difficult to distinguish legitimate MLMs from illegal scams such as pyramid or Ponzi schemes. MLM businesses operate legitimately in the United States in all 50 states and in more

than 100 other countries, and new businesses may use terms like "affiliate marketing" or "home-based business franchising". However, many pyramid schemes try to present themselves as legitimate MLM businesses.

### History

Like all-powerful concepts, Network Marketing has also met resistance due to a lack of understanding. There is no mystery to Network Marketing. It's just another form of sales and distribution. Network Marketing is 50 years young. In the early 1940's a company by the name of California Vitamins recognized that all their new sales representatives coming aboard were friends and family of their existing sales force, primarily because they wanted the product at wholesale cost. They also discovered that it was easier to create a sales force of a lot of people who each sold a small amount of product than it was to find a few superstars who could sell a lot of products.

So they combined those two ideas and designed a sales compensation structure that encouraged their salespeople to invite new representatives from satisfied customers, most of whom were family and friends, who each had the same right to offer the product and representative status to others, which allowed the sales force to grow exponentially. The company rewarded them for the sales produced by their entire group or network of sales representatives. Network Marketing

was born! A few years later, the company changed its name to NutraLite Food Supplement Corporations.

In 1956, NutraLite was joined in Network Marketing by Dr. Forrest Shaklee to gain a broader distribution of the food supplements he had developed.

Not long after, in 1959, former NutraLite distributors Rich DeVoss and Jay Van Andel started the Amway company as the American Way of marketing products. Like many truly innovative breakthroughs, the development of true network marketing was an accident.

Abuses of exponential growth haunted network marketing for years and it is still misunderstood today. One of the first abuses of the concept of exponential growth to generate income may have been the chain letter craze that swept the U.S. after World War I. The letters promised great profit if you would send a dime or a dollar to the person at the bottom.

The chain letters spread as far as Europe, and by the 1930's the U.S. post office estimated that 10 million letters were being mailed each day. Postal Authorities and law enforcement agencies battled the fraudulent schemes and the chain letter phenomenon began to subside in the early 1940s. Unfortunately, this scam spawned schemes which came to be known as pyramids, where money was given for the right to involve others, as no valid product which was being purchased from the company.

In 1974, Senator Walter Mondale declared such companies to be the nation's number one consumer fraud.

Law enforcement agencies moved quickly to clean up the abuses. In the mid 1970's, with no clear understanding of what constituted a legitimate use of network marketing, the Federal Trade Commission and state agencies across the nation turned their eyes to almost all network marketing companies. In 1975, the FTC filed suit against Amway, alleging that the company was an illegal pyramid and that its refusal to sell its products in retail stores constituted a restraint of trade.

Amway spent four years and millions of dollars in legal fees to clear its name. In 1979 the FTC (Federal Trade Commission) ruled that Amway was not a pyramid, that its revenue was generated from the sale of its products, and the FTC acknowledged network marketing as a legal and efficient distribution system. Network Marketing exploded in the next decade.

The 1980s saw a major shift as companies began managing the stocking and distribution of products as well as commission payments to their members. This allowed members to focus on selling. Today, most MLM companies act as logistics companies that take orders, ship products and calculate and pay commissions.

One of the reasons for the success of Network Marketing in the 1990's is that it is based on cooperation, not competition. Unlike in traditional business,

career advancement in network marketing comes directly from helping to create success with those that you introduce to the company. Network Marketing is sharing information that results in product sales. People involve themselves because they want to finally be compensated for what their efforts are really worth. They're involved because somebody cared enough about them to show them the awesome opportunity of network marketing. They get involved because they were ready to make a change.

With the arrival of the Internet, MLM companies have started to go online. Many established MLM companies began to use the Internet to promote their products. At the same time, many other new MLM companies started their businesses using the Internet, which is generally called online MLM.

### Compensation plans

Companies have devised various MLM compensation plans over the decades.

1. Unilevel or Stairstep Breakaway plans are the oldest and most popular. They feature two types of distributors - managers and non-managers - and three types of pay:

- Baseshop overrides are overrides of managers from their subordinate non-managers, collectively called a baseshop. This is the same as any other sales organisation.

- Generational overrides are overrides of managers from the baseshop of

managers who were previously their subordinate. Most plans compensate at least three generations of such managers.

- Executive bonuses are commissions for managers who exceed a sales quota. For example, 2% of the total company sales revenue may go to a bonus pool that is shared monthly pro rata to managers who exceed \$10,000 in that month.

2. Matrix Plans limit the width of each level in a distributor's group, forcing strong distributors to pile ("spillover") their recruits over people who did not sponsor them.

3. Binary plans limit the width of each level to two legs. Commissions are based on "cycles," where a distributor is paid a fixed amount whenever both legs achieve a certain number of sales units each. Commissions are paid incrementally when the sales volume in each leg matches.

4. Elevator or Matrix schemes feature a game board or a list on which each distributor pays in one or more product units to participate. When a certain number of units have been paid in, the structure splits and the earlier participant receives consideration. The Matrix scheme article discusses the legality of this plan. You must do your own research as with any other investment.

"We have the best compensation

plan.” We often heard this comment when we are investigating different network marketing companies. People anxious to show you their business opportunity would tell you stories of people making hundreds of thousands of dollars a month because of the business. It is true that exist a few people who really do make hundreds of thousands of dollars a month from their network marketing business, so I don't doubt the massive earning potential of network marketing.

The lure of making a lot of money draws many people into the business, but it is not recommend to look into a network marketing business primarily for the money.

“We have the best products.” This is the second most emphasized benefit that is presented by different network marketing companies. In fact, the number of companies that deliver their products and services through network marketing systems is surprisnly high.

We can find network marketing businesses that offer:

- Consumable home care products;
- Telephone services; real estate;
- Financial services;
- Internet Web sites;
- Internet market distribution, selling at discount just about everything that Walmart and K-Mart sells;
- Health care products;
- Jewelry;
- Tax services;
- Educational toys... and the list goes on.

*Example of Multi-level marketing companies:*

- Amway
- Avon Products
- Herbalife (health and wellness products)

At least once a month, we hear about a new network marketing company with a new twist on products or compensation plan. We may join some because we want the product or service they offer. But product or compensation plans are not the main reason who must encourage people to look into a network marketing business.

The main reason that stand at the base of choising one or another network marketing business is its system of education.

One problem meet in many business school is that many of the teachers have no real-life business experience. In network marketing, the people at the top who teach have to be successful in the real world—or they wouldn't be at the top. In the world of traditional business schools, you don't have to be successful in the real world of business to teach business. Maybe that's why the instructors in the traditional business education don't earn as much as some of the instructors in network marketing education.

Some of the more important real-life business subjects that network marketing companies teach include: an attitude of success; leadership skills; communication skills; people skills;

overcoming personal fears, doubts and lack of confidence; overcoming fear of rejection; money management skills; investing skills; accountability skills; time management skills; goal setting; systemization.

The successful people that we met in the network marketing business have developed all these skills from their network marketing training programs.

First job of individuals who want to join a MLM company is to invest the time to look past the compensation plan and products and really look into the heart of the company to see if it is truly interested in training and educating them.

That takes more time than just listening to a three-hour sales pitch and looking at colorful product catalogues. To find out how good their education really is may require that they get off their couch and invest some time going to their training and education functions. If they like what are hearing, than they must take some time to meet the people who do the educating and training.

Look carefully: most network marketing companies say they have great education plans, but many did not have the great education and training systems they claimed: the only training was a recommended book list - then they focused on training ou to recruit your friends and family into the business. But there are many network marketing companies that do have excellent education and training plans - in my opinion, some of the best real-life business training I have seen anywhere.

Regardless of whether or not you reach the top of the network marketing system or make much money, the training is of great value for the rest of your life. If the educational plan is good, it can improve your life for the better and maybe forever.

### **The praiseworthy of MLM**

Multi-level marketing, in principle, works the same way as the pyramid or chain letter schemes that we've all been offered with the only difference being in the product offered for sale. All of these programs work to some degree - because there are government restrictions and laws against the perpetuation of these ideas - most of them make a big splash when they are first introduced, and then quickly die out. However, the concept of initiating a program that sells itself via an endless chain will always be popular because it holds the promise of bringing riches if only the chain isn't broken.

So, multi-level marketing appeals to everybody because it's an opportunity for all the participants to get rich with a minimum investment, and very little time or effort or involvement. It works because everybody wants to become rich. it's an idea that anyone - regardless of education, background or basic financial status - can perpetuate from the privacy of his or her own home.

The basic fallacy of multi-level marketing is in the number of people each individual participant can easily enlist into the program.

After you've talked to all your

relatives, your neighbors, co-workers, and friends across town, you're more or less stymied as to new people to bring into the program. The bottom line is simply that you cannot recruit everybody you talk to - in fact, if you enlist 10% of the people you attempt to interest in the program, you'll be doing very well. You're going to get some rejections, and these rejections are basically what turns most people off - deflates their ego, drains their enthusiasm, and in the end, is the primary reason they drop out.

Regardless of what you sell, you must always have a goal in mind - you intend to sell 10 units of a product or recruit 10 new people into your program between now and the first of the month. you've got to believe that you can do it - want to do it - and then get out and beat the bushes until you do it! Once you've achieved this first goal you should take a day off and reward yourself with a night on the town or the splurging you've always wanted. But then, after setting a goal for yourself, and then proving that you can achieve it, you should set a new goal for yourself - if you recruited 10 new people into your program last month, then this month, you're going to bring in 15 new members.

### **Criticism of MLM**

A tutorial on market saturation hardly seems necessary in most business discussions, but with MLM, unfortunately, it is. Common sense seems to get suspended when considering if

MLMs are viable, even theoretically, as a profitable means of distribution for all parties involved. This suspension is created by a heightened expectation of „easy money“, but more on that later.

Interestingly, the issue of supply and demand is what brought the USSR to its knees. By design, the Soviet government tried to macro-manage supply, where bureaucrats would decide how many potatoes were needed, how much toilet paper, etc. Assuming these bureaucrats did the best they could, unfortunately their efforts to deliberately manipulate the control "knob" of supply and demand was not good enough. Notwithstanding their good intentions, they were usually wrong, which created huge shortages and surpluses, and led to a massive economic collapse.

Seeing the disastrous end of market naiveté in Russia should help clarify the fundamental problem with the MLM approach. In the real world, the profit of a company is directly related to the skill and prescience of the "hand" on the "supply knob," so to speak. In the USSR, that "hand" could not react fast or accurately enough to market realities through the best efforts of the bureaucrats.

With MLMs, the situation is much worse. Nobody is home. Even the Soviets had someone thinking about how much was enough! If the bureaucrat in Russia was having a hard time trying to play Adam Smith's "invisible hand" in setting the supply

level in the Soviet Union, then an MLM "executive" is in a truly unfortunate position. Not only is there no one assigned to make the decision of how much is enough, the MLM is set up by design to blindly go past the saturation point and keep on going. It will grow till it collapses under its own weight, without even a bureaucrat noticing.

MLM is like a train with no brakes and no engineer headed full-throttle towards a terminal.

All products and services have partial market penetration. Not everyone wishes to join a particular discount club, or buy gold, or drink filtered water, or wear a particular style of shoe, or use any product or service. No one in the real world of business would seriously consider the thin arguments of the MLMers when they flippantly mention the infinite market need for their product or services.

For most MLMs, the product is really a mere diversion from the real profit-making dynamic. The product or service may well be good, and it might oversaturate at some point, but let's get serious. The product is not the incentive to join an MLM. Otherwise people might have shown an interest in selling this particular product or service before in the real world. The product is the excuse to attempt to legitimate the real money-making engine. It's "the cover."

Intuitively, we all know what is really going on with MLMs. Just don't use the word "pyramid"!

"You see, if you can convince ten

people that everyone needs this product or service, even though they aren't buying similar products available in the market, and they can convince ten people, and so on, that's how you make the real money. And as long as you sell to a few people along the way, it is all legal." But the way to make money in all this is clearly not by only selling product, otherwise you might have shown an interest in it before, through conventional market opportunities. No, the "hook" is selling others on selling others on "the dream."

MLMs work 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.

The problem here is one of common sense. At a mere three levels deep this would be 1,000 people. There goes the neighborhood! At six levels deep, that would be 1,000,000 people believing they can make money selling. But to whom? There goes the city! And the MLM is just getting its steam going. Think of all the meetings! Think of all the "dreams" being sold! Think of the false hopes being generated. Think of the money being lost.

Nothing irritates a die-hard MLMer more than the preceding argument. If you point out the absurdity, for example, that if "the pitch" at an Amway meeting were even moderately accurate, in something like 18 months



Amway would be larger than the GNP of the entire United States, then listen closely for a major gear-shift: "Well, that is absurd, of course. Not everyone will succeed, and so the market will never saturate."

Well, which is it? Are we recruiting "winners" to build a real business, or planning by design to profit off of "losers" who buy into our "confidence"?

During "the pitch," anyone can make it work. "It's the opportunity of a lifetime." "Just look at the math!" But mention the inevitable saturation and the losses this is going to cause for everyone, and then you'll hear, "Of course it would never really work like that." "Most will fail," you will be told, "but not you, Mr. Recruit. You are a winner. I can just see it in your eyes."

If you are a starry-eyed recruit, it will grow as presented. If you are a logical skeptic, then of course it would never really work like that.

But the dialog usually never even gets to this. The fact that MLM is in a mad dash to oversupply is largely chided as mere "stinkin' thinkin'." Expert MLMers know how to quickly deflect this issue with parable, joke, personal testimony, or some other sleight of mind.

The prospective MLM initiate has to face and resolve these ethical issues:

- Do I want to be involved in encouraging people to be more materialistic?
- Do I want to sell a product that perhaps couldn't be sold any other way?
- Do I want to be a part of an

enterprise famous for slander, libel, and rumor?

- Do I want to be a part of a company that may employ criminals as marketing experts?

- Do I want to make money off my ability to convince people that an unworkable marketing system is viable?

- Do I want to be known among my friends and family as a person who tried to con people with a thinly veiled pyramid scheme?

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. Anyone who has any experience with an MLM has strong feelings, either for or against, and this is the problem. Polarization runs deep.

### Conclusions

The idea behind multi-level marketing (MLM) is simple. Imagine you have a product to sell. A common MLM product is some sort of panacea, such as a vitamin or mineral supplement. You could do what most businesses do: either sell it directly to consumers or find others who will buy your product from you and sell it to

other people. MLM schemes require that you recruit people not only to buy and sell your product, but who will also recruit people who will not only buy and sell your product but also recruit people....ad infinitum. Only there never is an infinitum to move towards. This may seem unusual to traditional business people. Why, you might wonder would you recruit people to compete with you? For, isn't that what you are doing when you recruit people to sell the same products you are selling? MLM magic will convince you that it is reasonable to recruit competitors because they won't really be competitors since you will get a cut of their profits. This will take your mind off the fact that no matter how big your town or market, it is finite. The well will go dry soon enough. There will always be some distributors who will make money in an MLM scheme. The majority, however, must fail due to the intrinsic nature of all pyramid schemes.

Multi-level marketing is system of marketing which puts more emphasis upon the recruiting of distributors than on the selling of products. As such, it is intrinsically flawed. MLM is very attractive, however, because it sells hope and appears to be outside the mainstream of business as usual. It promises wealth and independence to all. Unfortunately, no matter what the product, MLM is doomed to produce more failures than successes. For every MLM distributor who makes a decent living or even a decent supplemental

income, there are at least ten who do little more than buy products and promotional materials, costing them much more than they will ever earn as an MLM agent. The most successful MLM scheme is Amway. It has millions of distributors worldwide with sales in the billions.

The reason MLM schemes cannot succeed is because MLM marketing is, in essence, a legal pyramid scheme. The basic idea is for a sales person to recruit more sales persons. This is very advantageous to those who own the company and supply the products, especially since the sales persons in MLMs are also customers. But it is puzzling why a sales person would think it is to his or her advantage to increase the number of competing sales persons.

This is not to say there is no benefit to MLM membership. You get certain tax write-offs. You get to buy products, some of which you will be happy with. You get to go to inspirational meetings, some of which will make you feel good. You may meet new friends and you may even make a few bucks. But more than likely you will end up alienating some family and friends. You will probably end up buying more stuff than you sell. And you will learn a lot about deceiving yourself and others. You won't be allowed to tell anyone how you are really doing, for example. You will always have to think positive, even if that means lying. You will have to tell anyone who asks that you are doing

great, that business is wonderful, that you've never seen anything go so fast and

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