

Twelve Tests

for Evaluating a Network Marketing (MLM) “Opportunity”

By Jon M. Taylor, Ph.D., Consumer Awareness Institute

Network marketing (a.k.a. multi-level marketing or MLM, consumer direct marketing, purchasing or gifting network, etc.) developed from pyramidal concepts, which initially led to pyramid schemes, chain letters, and chain selling. While pyramid schemes are illegal, many MLM programs have managed to circumvent Federal Trade Commission (FTC) rulings and applicable state laws.

Legislation and court cases have defined pyramid schemes as plans which concentrate on commissions earned for recruiting new distributors and which generally ignore the marketing and selling of products and services. However, many MLM promoters, even with good products, emphasize recruiting simply because of a compensation system that rewards recruiting much more than retailing.

An MLM program that some enforcement agencies may not classify as an illegal pyramid scheme may for all practical purposes still be a product-based pyramid scheme (PPS). Strong pyramidal elements remain for most MLM programs, leaving participants with little chance of financial success (usually resulting in losses), except for a tiny percentage at the top of a hierarchy of distributors.

The following tests should help you avoid programs in which you will only be wasting your money, time, and effort.

✓THE OPPORTUNITY TEST

Were you approached primarily on the basis of the actual value and need for the products—or for the “opportunity?” If the latter, the program may be actually a pyramid device for enriching the company and a small group of upline distributors.

Another red flag to look for is promoters who talk of “getting in on the ground floor” or “riding the wave” of opportunity. Usually, the bulk of the income in these cases is already locked in by the founding distributors in the pyramidal hierarchy.

✓THE MARKET REALITY TEST

Many MLM recruiters point to the huge growth potential of their programs without considering the normal dynamics of supply and demand. Without adequate controls, saturation in any given market may soon be reached—at least in peoples’ minds.

Are numerous levels of distributors allowed—more than is needed to get the products out to customers? Also, ask if the company allows unlimited recruiting of distributors in an area—with no territorial protection or other provisions for preventing market saturation? If so, you may be buying a ticket for a flight that has already departed. You could be left holding a bag of empty promises and a worthless ticket.

✓THE PRODUCT TEST

Review the products offered and ask yourself:

Is it likely the products could be sold successfully on their own merits without going through a MLM distribution system? If nothing comparable is on the market, find out why.

Does the MLM company focus on legitimate products of value to consumers, or does it emphasize fleeting trends and timing, and exotic or secret formulas?

Are products of consistently high quality, and do they carry a buy-back guarantee? Can all product claims (such as health claims) be backed up by reliable research? Are orders filled and shipped promptly? And are manufacturing and expiration dates printed on consumable products?

✓THE COMPENSATION TEST

Can you as a distributor make a good income for the time you spend selling the products—without recruiting a single person? Or is the commission paid by the company for selling the products so low that you have to recruit a downline in order to earn a significant income?

Would distributors several levels above you—who had nothing to do with the sale—receive as much or more total payout per sale (including commissions and bonuses) from the company as you would get for selling the product or providing the service?

If the latter is the case, the emphasis is on income from a downline of distributors (that you would have to recruit), not on the sale of products. Even though such a MLM program may have escaped prosecution as a pyramid scheme, it may still be a de facto pyramid scheme (or PPS).

Your odds of success in such a program will not be favorable. While a few distributors at the top of the pyramid will be rewarded handsomely, as many as 99% (over 99.9% in some programs) of distributors beneath them will come away empty—most actually losing money, after subtracting expenses and product purchases. Also, in some programs, your quitting merely enhances the income of your upline—because income from your downline “rolls up” to those above you.

Don't fall for the line that it takes months or even years for most businesses to show a profit and that if you just “work hard and hang in there” you will make lots of money in this MLM program. Be aware that in other comparable settings, sales distributors usually show a respectable income within a couple of months, or they turn to something else.

Ask distributors who have been with the company for two or three months if they are turning a respectable profit—after operating expenses and product purchases are subtracted. If not, they are only fattening the pockets of their upline.

✓THE INCOME DISCLOSURE TEST

If an MLM recruiter touts huge income figures of top distributors, request that the company disclose average payout to distributors by percentiles (highest 1%, second highest 1%, and so on to the lowest 1%), so that you can determine your chances of success. Ask for **net payout (after subtracting product purchases) for all distributors who ever signed up**, including those not now active. If they fail to furnish such data, they are not providing the balanced information you need to make an informed decision.

Estimate the operating expenses for building your distribution network. For anyone serious about building an MLM business, a significant amount will be spent on telephone costs, travel, samples, sales materials, office supplies, mailing costs, printing and duplication, and (when friends and family don't respond) some advertising. **Most distributors wind up spending far more money on products and operating expenses than they bring in. The best source for expense information is ex-distributors, not current distributors who are in denial about how much they are actually spending.**

If less than 1% of all distributors earn the equivalent of a minimum wage for their time (after subtracting all expenses and MLM products purchased), you might want to consider a more profitable use of your money, time, and energy. (Some researchers estimate that for most MLM programs, less than 1% of distributors ever turn a profit.)

Another acid test of the profitability of an MLM distributorship is to **ask the person recruiting you to show you his/her last year's tax return**. It has been found that it is extremely rare for network marketing participants to show a profit for their networking efforts on their annual tax returns.

✓THE “PAY TO PLAY” TEST

Find out how high the expectation is for you to purchase products, services, training, etc., over a period of time, in order to be a serious participant. In other words, what will it cost you to “play the game?” Don't be fooled by a simple request for a small sign-up fee, soon to be followed by

endless invitations for specials on purchases of samples or inventory, accelerating bonus levels for higher sales plateaus, paid seminars, and training sessions or retreats.

This requirement (or strong suggestion) that you make large purchases of products over a period of time to qualify for increasing bonus levels or purchasing discounts is one sign of a product-based pyramid scheme. After months or years of fruitless effort and a garage full of products, some participants come to realize they have merely been paying into a pyramid scheme in the form of payments for unneeded products.

✓**THE PRICE TEST**

Are the company's wholesale prices low enough to allow a respectable profit when marking up for resale—at a retail price that is still competitive with comparable products through other sources? Or are retail prices so high that they must be sold at wholesale to achieve any volume?

If products are priced at a premium to support a large network of distributors, then the premium portion of the price could be considered the pyramid portion. So if a MLM product sells for \$40 and a comparable product would sell for \$20 at a typical retail outlet, the \$20 premium may be deemed the pyramid portion of the price and would flow to top distributors in typical pyramid fashion.

✓**THE GOLDEN RULE TEST**

How did you feel about the way you were recruited to do the business, and how do you feel about approaching your family and friends in the same way? **How important are your relationships to you?** Are you offended when they attempt to exploit your connection with them for monetary gain? **Would you want to do the exploiting?**

✓**THE TIME FREEDOM TEST**

The perennial dream of those with a pyramidal mentality is to be successful at recruiting a downline that will bring in enough money to support them so they won't have to work themselves—thus giving them “time freedom.” They can then “leverage” their time by living off the efforts of others.

If a recruiter promises that by working hard for a brief time period you will never have to work again, **ask what percent of their top distributors are no longer actively involved with the company—and never attend opportunity meetings.**

Ask veteran distributors when they last took an extended vacation. Were they able to do so without significant losses for not tending their downlines? And did any of them quit or scale down without experiencing major financial losses?

Better yet, ask for a copy of the recruiter's downline and upline. Contact distributors at several different levels to see if any have achieved “time freedom.” And if you know the spouse of any of the distributors, you might ask what problems the family has experienced due to MLM participation (intrusive phone calls, untimely visits to the home, and neglect of family and other duties by the distributor).

✓**THE HONESTY TEST**

Has the recruiter been devious or up front in his or her inviting attempts? And can the products and “opportunity” be sold without making exaggerated product and income claims? Ask for validation of each of the claims made.

If you find the truth frequently distorted, powerful and escalating incentives may be driving the recruitment. If normally honest persons feel the need to exaggerate claims to sell the products and the program, you may find yourself having to do the same.

✓**THE CREDIBILITY TEST**

MLM promoters who don't command respect themselves may lean heavily on the “credentials” or “character” of others involved in the “opportunity.” **If such references are used to excess, watch out.**

Such credibility links can be deceptive. Why? Because the ethics of MLM are so tricky to sort out that respectable and high level people have been drawn into the most problematical of programs.

✓**THE SUPPORT TEST**

Does the company offer an adequate support infrastructure to handle a temporary burst of volume?

Will your upline be there when you need them, or do they have a history of jumping ship when the next hot MLM deal comes along?

Are conferences and training programs, audio and video tapes, etc., free of charge (as is the case elsewhere for company sponsored programs), **or are you expected to pay for them—as another revenue source for the company and upline?**

A FINAL WORD

If you have found this flyer helpful in deciding about participation in MLM, you could be doing your friends and family a favor by sharing this information with at least five of them. Then ask each of them to share it with five more persons, and suggest they tell each of them to share it with five more, and

© 2000 Jon M. Taylor. **This flyer may be reproduced in its entirety** for consumer awareness, but may not be sold or packaged for sale without the author's written permission. It has been designed for easy reproduction on 8½ x 11-inch paper.

For more information on problems with network marketing and possible solutions, visit our web site— <http://www.PyramidSchemeAlert.org>. Or email: jonmtaylor@juno.com .

