What is this Thing Called *Multi-Level Marketing*?

A Statistical and Business Model Examination of the Economic Legitimacy of Multi-Level Marketing

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What Is this Thing Called Multi-Level Marketing is a statistical and analytical study intended to support the collaborative work of *International Coalition of Consumer Advocates*, an *ad hoc* network of consumer activists, attorneys, former regulators, economists, cult experts, and writers from around the world who are calling for greater law enforcement and investigation of multi-level marketing (MLM).

This report builds upon and adds further data support to the detailed letter addressed to the United States Federal Trade Commission (FTC) in October 2013, requesting an immediate FTC investigation of what is called the "multi-level marketing industry" and the enforcement of applicable laws and rules on unfair and deceptive trade practices. That letter was signed by 38 ICCA supporters from around the world and was accompanied by approximately 1,000 consumer petitions calling for regulatory action. The full text of the ICCA Petition Letter and a list and description of the 38 signatories can be viewed online.

A summary of the findings of the statistical analysis in this report is included in a more comprehensive report, authored by ICCA leaders, attorneys Douglas Brooks and Bruce Craig and pyramid scheme expert, Robert FitzPatrick, that includes an historical examination of the legality of multi-level marketing and is addressed to the office of United States Senator, Ed Markey of Massachusetts, who has called for greater scrutiny of the MLM industry.

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Painting by Dots

Wall Street wars still rage over Herbalife's legality; investors fret about claims that Nu Skin "brainwashes" Chinese recruits; by inference, Usana and Avon and other MLMs are implicated at home and abroad; the FTC is pressured by Latino, Consumer and Civil Rights groups to investigate predatory marketing by multi-level marketing (MLM); a US Senator has questioned the legality of a major MLM company. The FTC's prosecution of the popular MLM, Fortune High Marketing, revealed a 10-year recruiting rampage that duped hundreds of thousand of consumers. The consumer class action lawsuit against the Texas-based MLM, Stream/Ignite, making fraud claims against that MLM, is now certified by the court. After a 30-year era of ignoring this Main Street "thing", called multi-level marketing, the business media and Wall Street have seemingly awakened to ask what, in commercial terms, is this thing called "multi-level marketing"? The FTC has announced a formal investigation of Herbalife, the first publicized FTC investigation of a major MLM company since 1979.

As the inquiry into MLM has now moved into the halls of Congress and the FTC is officially engaged in examining icon of the MLM field, this report takes the occasion to aggregate and analyze hard data on three American prototypes of multi-level marketing, Amway, Nu Skin and Herbalife. The hope of this analysis is that, like painting-by-dots, a tedious compilation of aggregate data will result in an image that is recognizable and definable by the financial community, legislators, journalists and regulators.

This study's look into MLM covers the participation of nearly one and a half million American households in 2012 who invested about $2.3 billion in product purchases, joining fees and shipping costs, and far more when conference costs, transportation, training, sales leads and non-cash opportunity costs are factored.

If it is not apparent that MLM is one of the biggest *financial* "things" to hit Main Street America since credit cards, consider that Amway, Nu Skin and Herbalife, the focus of this study and which had 1% of all American households under "sales" contracts in 2012, are just three of perhaps as many as 500 clone companies, all relentlessly soliciting tens of millions Americans every year to invest in their "unlimited" income plans. These plans all amount to the same essential proposition: *buy into a "distributorship" for some unadvertised product and infuse it with value by recruiting others to also buy a distributorship and recruit others to do the same, etc.*

MLM's legality and financial viability are a matter of obvious concern to some on Wall Street. About a dozen MLMs are publicly traded with aggregate market capitalization of about $30 billion. For Wall Street, though, multi-level marketing is a side show. On Main Street, MLM is a far more serious matter. With the presumptive endorsement of the MLM "business opportunity" by a silent FTC over the last 30 years, MLM has found its way into every household that is facing economic pressure as an "alternative" economy, an answer – perhaps the only answer – to current economic woes. Its unique claim to *endlessly* expand is trumpeted across the internet, with little data to refute the astonishing assertion. Its form of "direct selling" in which the "direct seller" does not actually need to sell but only needs to "buy from yourself and find others to do the same," is whispered about in church pews; its "unlimited" income promise is hyped in coffee shops; MLMs are promoted at the office and, most important, argued and leveraged among family members. Its astounding economic promise infuses ordinary fruit juices, skin lotions, protein powders and food supplements with seemingly magical properties, capable of curing devastating illnesses and halting the ravages of aging, according to promoters. More than any other segment of American commerce today, MLM claims to represent the *American Dream*. It carries that American banner of hope and promise to over 100 other countries. Tens of millions are led to *believe* in MLM as their *only* hope and the purest expression of American-style capitalism.

Commerce or Cult

With such economic promise, MLM commands extraordinary power over individuals, leading some to abandon jobs and family, young people to quit school and devote themselves to recruiting, and some people to dedicate decades moving from one MLM to another, despite great financial losses, in pursuit of its utopian promises.

This paper addresses the question whether MLM is a real sales business or a financial fraud. But, viewed in street-level practice not just in statistical outline, the question is actually whether MLM is a business at all or an “economic cult.” Beyond its manifest power to mesmerize and captivate the imagination of followers, the question of MLM as a cult is raised because it is the only business that is allowed to teach an "occult" phenomenon as a business plan. The occult phenomenon is the “endless chain”, a funding source for all consumer/investors that its promoters claim is “infinite” in depth, capable of creating "unlimited" payments for all participants from a limited, finite amount of money, that is, the amount invested by the participants themselves at any given time. MLM claims to offer a parallel “retail” sales opportunity, called “direct selling,” while also perpetually adding to the number of retailers in all areas, transcending or ignoring the economic realities of retailer competition, pricing pressure and market saturation.

Cults traffic in utopian dreams, mystical beliefs, and the acclaimed power to offer a kind of salvation to followers, but only if they unquestionably believe and unalterably follow the direction of the leaders, including what to think and speak. While they proliferate in political and religious realms, cults are normally precluded from business due to the factual and measurable practicalities of commerce. But MLM is not limited by these measurable practicalities. It is the only business that is legally allowed to employ the “endless chain,” presented as an eternally expansive recruiting channel of “salespeople” in which the funds of later investors can be transferred to earlier ones, *perpetually*. In the *financial* world, this is regarded as Ponzi scheme. On Main Street, it is just this thing called multi-level marketing, generally perceived as perfectly legal and financially viable for all to invest in.

Legal to Sell or License to Steal

At present, the US government effectively allows the magical endless chain to operate on Main Street as a "business model", including its characteristic – and always impossible to fulfill – infinite expansion/unlimited income promise. The endless chain, also called pyramid scheme, is permitted as long as the endless chain enterprise also offers a *retail sales opportunity* in addition to the income gained from building a recruiting chain, and as long as the funds are transferred through *product purchase transactions* among the participants themselves. In short, as long as the endless chain is dressed to resemble a market-based business and uses the terminology of sales to describe the transfer of funds, all the elements of the classic pyramid scheme – endless chain, closed market, money transfer – have been legally permitted for the last 35 years.

Since 1979, when the Amway Corporation was given a legal green light by an FTC Administrative Law Judge (ALJ), the viability and legitimacy of the endless sales chain model and its inevitable, devastating economic consequences, have not been publicly examined, until recently. The endless chain enterprises have also been protected against regulation or law enforcement by one of K Street's largest political lobbies, the Direct Selling Association (DSA). Amway itself has become one of the most politically active companies in America with prominent leadership in the National Republican Party. Over the intervening 35 years, the "Amway model" exploded into hundreds of clone enterprises and spread, under the auspices of US legality, to over 100 countries.

The challenges to Herbalife that have been recently raised on Wall Street and Main Street echo the argument raised by FTC prosecutors 35 years ago against Amway – which were rejected by the FTC ALJ – and all various class action lawsuits every since against other MLMs. The charges boil down to pointing out an obvious fact: there is no such thing as an "endless chain" and any promise of income, discount or financial return based on it is *inherently* deceptive and must result in virtually all participants suffering financial disappointment. Infinity is a supernatural concept, a factor for religion and philosophy to ponder. It is immeasurable and, therefore, no financial value could be placed on it or an income promise be based upon it. Any money charged that is based on a promise of infinite expansion or "unlimited" rewards is, therefore, deceptive.

The MLM Industry

The Direct Selling Association claims that the MLM industry annually generates $30 billion on Main Street USA from 15 million "direct sellers." But this "sales" figure projects *retail* sales by the 15 million "direct sellers." In fact, none of the major MLMs verifies such sales and no physical evidence of significant and profitable retail selling exists. Moreover, most MLMs now say the great majority of their salespeople "self-consume" the products, not resell them. Measuring revenues only in terms of *actual* sales to the millions of MLM distributors shows, without assuming or projecting a retail margin, a USA revenue level of about $20-25 billion.

Companies	All Distributors USA 2012	Total Revenue USA 2012	Total Revenue Global 2012
Amway	743,500	$1.2 Bil	$11.3 Bil
Nu Skin	193,826	$242 Mil	$2.2 Bil
Herbalife	493,862	$816.9 Mil	$4.072 Bil
Total	**1,431,188**	**$2.259 Bil**	**$17.57 Bil**

Using that figure, plus the DSA's claim that there are as many as 15 million households under contract to MLM companies, the three MLMs examined in the this report, Amway, Nu Skin and Herbalife, account for more than 10% of the entire USA industry. Aggregate USA revenue of the three was $2.259 billion (in sales to the distributors) and total distributors of the three were 1.43 million at the end of 2012. This is an adequate slice of the total MLM business and taken from among the oldest, largest and best known companies to be representative of the "industry." What does it show us?

Black Box

The data for this study were compiled from official "income disclosures" of the three companies, SEC filings of two of them and publicized statements from top company officials. The data aggregate business fundamentals such as total USA revenue, total numbers of "salespeople" at year-end 2012, mean average incomes gained by each of the various "levels" of the MLM sales channel, potential per capita *retail* profit for the salespeople, and mean average *purchase* levels of the salespeople. The data also show how funds called "commissions" paid to USA distributors, are allocated among the participants according to their respective ranks in the sales chain.

There are several factors in this data analysis that skew or otherwise alter the picture which is already murky due to the shallowness and scarcity of the data that these companies make available. For example, all the disclosed "averages" are *mean* averages (total dollars divided by total participants). *Median* (half more and half less) would obviously provide a truer picture to a potential new recruit. The *median* average income for distributors for all three companies combined, including for median of the incomes of the top 37% that are considered "active" or leaders is *zero*.

The median average income for distributors of all three companies combined including the median for the incomes of the top 37% that are considered "active" or "leaders," is zero.

More than half of all distributors and more than half even of the upper group of "active" distributors earn nothing in commissions. If product costs and other business expenses are factored, the *median* is a *negative* number.

Additionally some companies employed the statistical manipulation of taking average payouts per month and then multiplying these averages by 12 to produce what they call "annualized" average incomes. This is a false statistical representation. It in no way indicates what is paid annually on average to distributors and has nothing to do with "average" distributor experience. The monthly figure is composed of monthly payments to different individuals each month, not the "average" income gainer, the majority of whom earned zero and, factoring costs, are in the red.

Nu Skin, engages in the most egregious use of data misrepresentation. Ninety-five percent (95%) of all Nu Skin distributors earn *nothing* in payments from Nu Skin. Eighty-seven percent (87%) of those defined as "active" also *earned zero* in commissions. When Nu Skin publishes the statement in its "disclosure", *"In 2012, the average monthly commission paid to U.S. Active Distributors who earned a commission check was $1,010.26, or $12,123.12 on an annualized basis*", the reader must first know that Nu Skin factored out 95% of all participants. The reader must also know that the "annualized" figure does not represent annual "income". It merely multiplied the monthly payments by 12. It does not mean that the "average" receiver of a check actually made this much in a year or any significant number of them did. In fact, of those who received checks, the ones in levels with average incomes below this published figure of $12K constituted 91% of the total of those getting checks, on average, they earned only $2,472.

These are extraordinary and deviously designed misrepresentations, rendering the "disclosure" useless for due diligence without careful use of some algebra.

Other factors that serve to mislead potential recruits and skew the results of an analysis include that business costs are not disclosed, so all "incomes" are merely dollars received. Those "income" figures are not to be confused with actual profit. Related to this factor is that costs factors, which are an obvious element of all "business opportunities," are not even estimated, so no calculation can be made as to actual profit, if any, even for those at the top ranks. All product purchases are incentivized with cash or "points" leading to cash, yet the disclosures make no reference at all to the most basic element of "distribution", that is, inventory. Even costs of demonstration products are ignored.

One of these skewing factors bears special notice. The payments to all USA-based distributors include rewards based on purchases made by sub-distributors *outside the USA*. Since the great majority of all income for these three companies comes from outside the US (80 - 90% in all cases), the incomes of the very top level distributors are significantly inflated in relation to US revenue. This, in turn, inflates the "mean" average of the upper sector.[1]

None of the companies discloses the geographic origins of the rewards. The withholding of this geographic source can be grossly misleading to a new recruit. Without knowing that much, perhaps nearly all, of the highly promoted incomes of the top "leaders" may be coming from as far away as China, the USA recruits may believe they could also achieve those income levels by recruiting locally.

Companies	Top 1% (approx.) of Actives and Leaders • Total Number • % of Entire Chain • Average Income	• Total Payout to the Top 1% of Actives • % of Total Commissions Paid to Top 1% of Actives
Amway	• 3,345 (.97%) • 0.42% of entire sales chain • $108,675 av. income p. yr.	• $363,520,214 • 44%
Nu Skin	• 997 (1.29%) • 0.5% of entire sales chain • $103,030 av. income p. yr.	• $102,625,644 • 81.7%
Herbalife	• 1,185 (1.04%) • 0.24% of entire sales chain • $206,638 av. income p. yr.	• $244,866,604 • 66%
Total	• 5,527 • 0.39% of entire sales chain • $128,643 av. income p. yr.	• $711,012,462 • 54% of all payouts

The Peak of the Pyramid

The most glaring data point from the analysis is that only about 5,500 out of 1.4 million people are in the levels of the chain in which the disclosed average income approximates what might be called a "livelihood", $60,000 or more a year in gross income *before* all purchases and business expenses are subtracted. This peak of the pyramid (0.39% or one in two hundred fifty) gained a *mean* average of about $129,000 a year in gross income,

[1] Amway data, for example, show total commission payments of 69% of USA revenue but Amway pays only about 40% of total revenue in commissions. Herbalife data shows 45% of USA revenue paid out but SEC filings show only about 33% of net revenue paid in commissions.

before expenses. (the *mean* average is skewed upward by the extremely high incomes of the tiny few at the very peak, whose incomes are globally based.) They received 54% of total commission dollars paid out by the three companies. In total, this tiny group at the top of sale chain received the equivalent of 32% of the three companies' entire USA revenues. The payments are based only upon the *purchases* – not sales – of the other 99.6%.

The paucity of "success" in the industry raises obvious business model questions. What did this top 0.4% do to receive over half of all sales commissions? Management genius? Super-sales volumes personally? Hands-on training? None of these traditional "values" on which commission percentages are normally based apply. The top players are light years removed from the actual selling and recruiting events below, though they stimulate it with promotions, conferences and rallies and ultimately every person in the entire chain is in their "downline", a theoretically infinite genealogical chain of recruits. At the absolute top, the chain immediately divides under the top recruiters into their various "lines" of sub-distributors that, theoretically would compete with one another for sales and new recruits, as all independent distributors do in any geographically unprotected open market. But, lines of distributors within these MLMs are contractually prohibited from soliciting or even communicating with one another's members. Competition between the lines of sales is prohibited by Amway. Sub-distributors are locked into their "lines" for purchasing, marketing support and pricing. They cannot negotiate.

The top 0.4% receive an amount equivalent to 32 cents of every dollar spent by the bottom 99.6% of the USA distributors.

The sub-distributors in the lower ranks cycle in and out annually at extraordinary rates, precluding any significant management or "training" role for the top members. Indeed, with little verified retail selling, the only function to manage or train for is the national recruiting system. Since these 0.4% distributors are not equity owners, their commission apportionments are based purely on respective position on the sales chain, and those positions are sustained by a never-ending recruiting program. No one is selected or promoted as in a normal management structure. The volumes of persons recruited is the only determinant for "executive" position on the MLM sales chain. It follows that if the recruiting ends, the income does too. The obvious conclusion is that the top 0.4% gained the lion's share of the rewards because it fulfilled the most valued and critical function of the model, recruiting salespeople who purchase inventory.

A Model that Has No Name

But even before such an assessment of what the top tier does for its money, a far larger issue for evaluation arises, indeed the most fundamental of all factors in commercial analysis. If this be a sales channel, w*ho are the sellers and who are the buyers?*

Officially, MLM companies report to the SEC that they sell "through" independent distributors. So, the companies sell to authorized "distributors" who do what all distributors, *by definition*, do – resell to end-users. It is also normal that managers would earn money from the actual consummated sales of the sub-distributors they recruit and manage, proportionate to their value in the sales cycle, including finding and persuading the prospect, bearing the sales costs and other logistical expenses.

If this be a sales channel, who are the sellers and who are the buyers?

Applying these traditional roles and standards, however, proves useless in examining MLM. In recent years, the largest MLMs have redefined the MLM business model to something that has no name and no precedent. Abandoning Amway's 1979 argument to the FTC Judge that its revenues, and its rewards to uplines, were ultimately sourced from retail purchases by non-distributors, MLMs, including Amway, now say distributors *are* their customers.[2] In the new definition, MLM companies sell products "directly" to some distributors, whom they describe as upper segment of a group that itself is in the upper echelon, called "active" or "leaders". These upper level distributors then "sell to" (not manage) other distributors who should be viewed not as contract distributors at all but as ordinary "end-users", i.e., the end of the sales chain, not the channel *to* the open retail marketplace.

Inside the sales channel, prices are fixed; trade is restrained; competition forbidden.

The problem with this un-named business model is that these companies have no "direct" sales forces that could do such "direct" selling to the thousands of top-level distributors. They have no "national" or "in-house" accounts of their own. *All* sales are accompanied by large commission payments to some members of the *contract* sales force. This is obviously "third party" sales, but who is the third party?

- *All* the MLM salespeople, those now defined as "sellers" and those re-defined as "end-users", are under the same legal contract and are offered the same income proposition.

[2] In the final ruling in 1979 on the FTC's charge that Amway was an illegal pyramid scheme, the FTC Administrative Law Judge concluded, based on Amway's executives' sworn testimony, that Amway was not a pyramid. He wrote, "The Amway system is based on retail sales to consumers... Amway is not in business to sell distributorships and is not a pyramid distribution scheme."

Yet, in a Feb. 29, 2012 video interview of Amway executives, Doug Devos and Steve Van Andel by *Wall Street Journal* reporter, Dennis Berman, the new MLM narrative in which the *distributors* are the retail customers was made plain.

WSJ Dennis Berman: What percentage of the end products are sold to the general public and not to the Amway salespeople directly?

Amway Doug Devos: That's always a challenge to kind of find exactly what that number is. But its a large percentage. Probably… our research probably about at least half or more would go to an end-user and ultimately all of its goes to an end-user. Even if somebody happens to be a distributor, they are their own best customer. So I would say on a strictly speaking standpoint, a hundred percent, because everyone, at the end of the day, is a customer and they see value in the product or else they wouldn't buy it.

Berman: Right

(http://online.wsj.com/article/FE12F29C-D022-42B8-8ACD-16A114E0DA96.html#!FE12F29C-D022-42B8-8ACD-16A114E0DA96 *Minutes: 16:20 - 17:00*

- *All* are offered "incentives" in cash or "points" (that lead to cash) to buy goods *personally* and to accumulate rewards through increased purchasing and increased recruiting of others to also buy personally and recruit others.
- All buy under the same *contract* terms that impose vertical trade restraints on *all* the contractors, including those the MLM now claims are actually "end-users." All are legally classified as *resellers and* are subjected to the same *channel management* restraints, including those re-defined as "end-users."
- The contracts restrict whom the contractors buy from, if they are re-defined as "customers", and whom they can sell to if they are deemed "salespeople."
- As contractors, even if they are re-defined as "customers", if they ask for a refund, they must resign their contractor status, lose discounts for as much as six months, and forfeit forever whatever sales organization they may have built up.
- All distributors, including those that the MLMs now re-define as "end users" are charged sales tax based on a higher *retail* price, on the presumption that they will *re-sell* the goods for a profit, not keep them as end-users would. States are receiving millions in sales tax from MLMs on retail transactions that apparently never occur and were never even intended.
- The contracts strictly prohibit *discounting* by the distributors that are deemed "salespeople" when they sell to the distributors that are re-defined as "customers." Prices are fixed. Trade is restrained. Competition is forbidden.
- Neither the "customers" nor the "salespeople" are allowed to sell other MLM products to anyone in the MLM while they are under contract. They cannot sell to their *former* downline, even after they leave the MLM.
- The terms of the *contract purchases* prevent criticism of the company or its products.

Pricewaterhouse Seal of Approval?

Under no known commercial precedent, business law or practice of marketing could such transactions be considered competitive, open-market retail selling. They are non-competitive and they include no retail profit. They all occur inside a sales chain, under *reseller* contract terms.

	2011
Retail sales	$ 5,427,844
Distributor allowance	(2,483,122)
Product sales	2,944,722
Shipping & handling revenues	509,815
Net sales	$ 3,454,537

Herbalife's "Itemized" Allowance in 2011 SEC filing of Distributor Profits Gained from Retailing

Yet Pricewaterhouse Coopers International gave this model its endorsement in the recent audit of Herbalife's books. It even endorsed Herbalife's famously itemized "distributor allowance", presented in its 10K as the distributors' retail profit, and the largest single part of the total distributor profits. The retail profit is supposedly based on all the distributors having sold at full retail price every inventory item they purchased, without discounting, and without self-consuming or giving away even a dollar's worth – surely a first in annals of sales history!

The "distributor allowance" contradicts Herbalife's other claim that most of its distributors sell nothing at all on a retail basis and therefore could not have generated an "allowance." Rather, the distributors' own internal purchases under wholesale contract *are* retail sales, Herbalife has told investors and the media, though no retail profit is gained and the buyer and seller were both contract "resellers."

In a letter to the chairman of Pricewaterhouse Coopers, Robert Moritz, *Pyramid Scheme Alert* alerted him to the fiction of the "distributor allowance" and highlighted the *impossibility* of Herbalife's conflicting claim that internal channel transactions are open market retail sales to end-users.[3] *Both cannot be true, but both can be false*.

The letter explains that under terms of the Herbalife contract, "Once enrolled, a distributor cannot switch from one upline distributor – who receives a commission on his/her purchases. Conversely, a distributor cannot solicit distributors in another distributors' downline. The so called "retail customers" who are distributors cannot shop the so called "retail sellers" inside the "sales network" for a better price or for any other reason."

Blaming the Victim

Herbalife, like other MLMs, insists that the purchases made by the vast majority of the distributors be reclassified as ordinary retail transactions that are unaffected by the distributors' contractor status, trade and pricing controls, the "unlimited income" offer or purchase incentives. As part of this same redefinition of most distributors as end-user, retail-buyers, they also assert that all statistical analyses of overall financial loss rates or attrition rates among participants are erroneous because such reports attribute financial losses to people who were not seeking income in the first place, just the company's products or perhaps only the fun and camaraderie of being in the network.[4]

They base this remarkable re-definition and re-interpretation on what the companies claim to be able to divine as the *true* intentions and hopes of most distributors relative the contract's income proposition. They say they know why so many fail to earn any income. It is because they *never tried*.

The thought-stopping, circular logic is expressed in the MLM mantra that is preached from every MLM pulpit, "Only quitters lose and only losers quit."

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[3] http://pyramidschemealert.org/wordpress/wp-content/uploads/2014/02/Memo-to-PWC.pdf

[4] In ruling on the 2007 case by the UK government to close Amway down in the UK as an "inherently objectionable" (deceptive and harmful) enterprise, the presiding judge addressed this claim that most distributors joined Amway (99% never earned a profit) only to "self-consume." He wrote, "It may well be, as he submits, that they are entirely rational beings who make the deliberate choice to become IBOs but not actually seek to derive an income, content simply to self-consume. But I find that speculation deeply unsatisfying. In terms of what is possible it is equally possible that many IBOs are seduced by a dream, find the reality of the Amway business opportunity very different, for reasons of self-esteem will not admit failure, and end up simply as purchasers of Amway products for self-consumption. In terms not of what is possible, but of what is probable, it seems to me highly improbable that such large numbers of people signed up to the Amway business opportunity in order not to make any money (or even to lose it) – especially when the survey responses indicate that long term income potential, improvement of lifestyle, fulfillment of personal dreams and supplementing of current income are regarded as very important to joiners. I think the probability is that the reality turned to be different from the expectation."
The final order of the judge in the UK case which details the facts and statistics can be viewed online.

How do the MLM companies know what people are thinking when they sign the sales contract or make a purchase and what they later intend or wish for? How do they know these contractors are not affected by the *purchase incentives* leading to upward movement on the chain and its lucrative rewards, the glossy images of Ferraris and Rolex' on the MLM website, the *infinite* expansion offer, the remarkable testimonies of wealth, success and happiness from people "just like you", or that they were unaffected by the excoriation of losers and quitters or the ominous whispers of their upline about the *last best hope*?

MLM leaders say they know that most distributors have no interest whatsoever in the contract or the rewards because these people never *successfully* recruited anyone else or gained a commission payment.

In effect, MLM promoters make the *consequence* the *cause*. But for companies that claim the capacity to expand sales channels "infinitely" and to offer recruits "unlimited" income, this philosophical switcheroo of making end-results the existential proof of first cause should not be too difficult. If you fail, you never tried, and therefore failed, they explain. Failure is only and always the responsibility of each participant and no one else, certainly not the MLM company's, deceptive claims or promises, the state of the market or terms of the contract. This thought-stopping, self-incriminating, circular logic is expressed in the MLM mantra that is preached from every MLM pulpit, *"Only quitters lose and only losers quit."*

Buying More than Selling

Companies	Average Income of 99% "Active" or "Leader" Distributors Below the Top 1% • Annual • Weekly	Number of "Active" or "Leader" Distributors Below the Top 1%	Total Payout to All "Active" or "Leader" Distributors Below the Top 1%
Amway	• $1,375 per year • $26.44 p. wk.	338,655	$465,487,786
Nu Skin	• $300 per year • $5.77 p. wk.	76,359	$22,911,626
Herbalife	• $1,116 per year • $21.46 p. wk.	111,900	$124,936,556
Total	• $1,164 per year • $22.38 p. wk.	526,914	$613,335,968

But let us push on with viewing MLM in the way that it describes itself, a business that, by selling mostly or only to its own distributors, has eliminated need for advertising, brand equity, product differentiation, competitive pricing or pesky customers who aren't bound by non-negotiable price-fixing reseller contracts.

What about those immediately *below* that 5,500 who gain the average income of $120+K a year? These are distributors who are also "active" or are "leaders." If they are not making the big bucks, are they at least gaining on average the much heralded "part-time" incomes "from home"?

The data show that the average income gained by the bottom 99% of the "leaders" and "actives", the upper 525,000 in number out of the overall total of 1.4 million, is only about $1,160 a year. This is less than the average annual purchases of all the distributors, which is about $1,600 a year. In other words, after purchasing goods themselves, the bottom 99% of the "leaders" and actives" – and remember, the leaders and actives are the top 37% of the entire chain – are in the hole by about $500, on average, just from buying the goods. What their true losses are is unknown since the companies offer nothing in the way of average or expected business costs in the "disclosures" made to new recruits.

Known for Decades

The figure is startling, but it is far from new. More than 30 years ago, the state of Wisconsin revealed the same pattern when it brought a lawsuit against Amway for making deceptive income claims. Wisconsin's Amway recruits, the state charged, were routinely told they could earn $12,000 a year within just 3 to 9 months of signing up. From court ordered discovery Wisconsin regulators found that only the top 1% of the total sales chain, the so called "Directs" who were about 200 out of 20,000, gained an average of $1,200 a month. Within this group, only about 42 individuals, 0.2% of the entire channel, gained the equivalent of today's livelihood figure ($20,000 or more, the equivalent of $60,000 or more today, factoring inflation). The incredible story of Amway's deceptive recruiting campaign in Wisconsin was reported on the popular investigative news show, *CBS 60 Minutes* in which correspondent Mike Wallace interviewed Wisconsin's Assistant Attorney General, Bruce Craig, who filed the suit.[5]

So, the (less than) 1% pattern was revealed in 1979 along with the less-than-one-half-of-one-percent pattern for the top gainers. Wisconsin's even data went a step further. It showed that even these paltry numbers are illusory because business costs are not revealed. Among Wisconsin's top Amway distributors, on average, the costs wiped out the income and then some. On average, this top 1% group reported an *average net loss* on their tax forms of $918. Net profit, therefore, accrued only to an absurdly small group, in cruel contradiction to Amway's promotional claims. This occurred only months after the FTC had given Amway a get-out-of-jail pass, which has been valid for 35 years, with no one from the government ever looking again to see if any Amway recruits, more than a fraction of one-percent, earn a profit.

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[5] From the transcript of the *60 Minutes* show:

CRAIG: We're charging them with deceptive business practices because of the use of those hypotheticals because they so vary from what we feel is REALITY.

WALLACE: [voice over] Bruce Craig investigated some examples used in Amway literature. Examples that said that Amway distributors could make in excess of $1200 a month. Money that some Amway distributors could be earned with just a few hours a week. But after looking at the average income of the 20,000 Amway distributors in Wisconsin, Craig came to the conclusion that such a claim was outlandish.

[to Craig] Surely, SOMEbody's making that kind of money.

BRUCE CRAIG: Yes. That's correct.

WALLACE: How many? Percentage wise.

BRUCE CRAIG: About one percent.

WALLACE: [voice over] Amway DID make the disclaimer that $1200 a month was ONLY hypothetical but that still doesn't convince Bruce Craig.

BRUCE CRAIG: If the figure of successful distributors was 1 out of 5 as opposed to 1 out of 100 we wouldn't be in court right now.

WALLACE: [voice over] And, Craig says that even the distributors who, on paper, earn an average of $14,000 dollars a year in Wisconsin actually earn a lot LESS. How much do they actually make?

BRUCE CRAIG: After business expenses, a net income of minus $918.

WALLACE: WAAAAIT a MINute! The direct distributors who make a gross income on average of over $14,000 wind up losing almost $1000 after business expenses?

BRUCE CRAIG: On average. Yes.

Verified in the UK

In case the Wisconsin data is viewed as too old to be relevant, one other statistical portrait of MLM's greatest representative, Amway, came to light in 2007 that almost perfectly matched Wisconsin Assistant Attorney General, Bruce Craig's 1980 findings in his state.

In January, 2006, the Secretary of State for Trade and Industry began inquiries into Amway, and one of the Amway-related US-based "tools" schemes that sells "motivation" materials to Amway recruits. After a year of investigation the Secretary of State presented a petition for the winding up (shutting down) of Amway in the UK as an "inherently objectionable" enterprise. Ultimately, a federal judge did not order Amway closed but to significantly modify it operations. Amway mostly ceased operations in the UK.[6]

The investigation revealed details of Amway in the UK, including:

- Amway had approximately 30,000 UK households under contract, about one in 700 households, and churned as many as it recruited each year.
- Between 2001 and 2006 the proportion of Amway sales representatives not earning any bonus income varied between 69% and 78%. In year 2004/5 only 74 out of 25,342 IBOs earned more than $15,000 by way of bonus. (about one in 200).
- Factoring the most basic business costs, the state prosecutors estimated that at least 93% did not earn enough even to cover the costs and joining fees.
- For the period from 2001 to 2006, 95% of all bonus income was earned by just 6% of the IBOs; and 75% of all bonus income was earned by less than 1.5% of IBOs.
- At least 60% of Amway's UK sales volume was made to 91% of IBOs who did not retail the products, but rather presumably "self-consumed" them at a volume of about $1,500 a year, on average.

Interestingly, the UK investigators found that Amway UK, the corporation, had consistently suffered corporate losses averaging over $4 million a year. The Amway operation, it stated, subsisted not from UK operations, which lost money every year, but rather from dividends gained from owning shares in Amway Korea. Amway UK was just one arm of the octopus of Amway's global operations with funds moving in unchartable directions. It led to hundreds of thousands of UK citizen losing money, time and other opportunity costs and, on paper at least, the company itself showed no profit on which to pay income taxes to the UK government.

The Ghosts of Madoff and Ponzi

Beyond the question of how a sales business – that uses no advertising – can generate millions or billions in revenue year after year with virtually no salespeople gaining a net profit, there is an even more confounding question. It is the question on which the legality of the business depends. If the upper end or some part of the upper end of the channel is the only true sale force, who then are their *customers* and how much do those customers buy, on average? Is this a closed-market endless chain? Is it an open market

[6] The final order of the judge in the UK case which details the facts and statistics can be viewed online.

sales business? Are the distributors the customers? If so, how could any new distributor gain a profit, if not by recruiting, that is, by extending the chain? It turns out that MLMs have made this fundamental question a trade secret. No one knows who or where Amway/Nu Skin/Herbalife's customers are or how much they buy, on average.

If the very bottom two-thirds of the Amway/Nu Skin/Herbalife chain, about 900,000 souls, the so called non-leaders or what the MLMs term "inactive", are the main base of "customers" and the true end-users, how much of the goods did they buy in total? A quick calculation, would show the bottom per capita annual purchase would have to be about $2,500. ($2.259 bil. ÷ 900,000 = $2,510) This surely could not be true of a group churning at a rate of 50-90% a year. $2,500 of Herbalife protein drinks per person? Nu Skin lotions? Amway soap? It cannot be.

If the upper end or some part of the upper end of the channel is the only true sale force, who are their customers and how much do they buy, on average?

But what if the "leaders" and "actives" also "self-consumed"? Then, *everybody*, active and inactive, leader and follower, would be buying about $1600 per capita, ($2.259 bil. ÷ 1,431,188 = $1,578). This figure still challenges believability as open market consumer purchases of unadvertised, commodity goods that are also generally higher priced than similar goods in stores. If they are *all* buying just for their own use, why do they all sign *sales contracts*? If there is little or no retailing occurring, why is the retail price so high or why is there one at all? Why, after they *all* sign the same contract, do only *some* engage in recruiting and others – the companies say – don't show the slightest interest to recruit? How could the two groups be so cleanly divided? And then, among the "actives" who do "try" why are so few – less than 1% on average – able to enroll and maintain enough "downliners" to make more than they spend? It makes no *business* sense.

Astute readers will recognize this confusing inquiry as a restatement of the famous question asked by David Einhorn of Greenlight Capital in 2012 during an Herbalife investor conference call that caused Herbalife's stock to go into free fall.[7] The remembrance of that event returns us to the most basic of all question that is addressed in this business model analysis – *who is selling and who is buying, and how much is merely transacted internally?*

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[7] http://blogs.wsj.com/marketbeat/2012/05/01/the-einhorn-herbalife-exchange-transcript/

(Q – David Einhorn): I got a couple of questions for you. First is, how much of the sales that you'd make in terms of final sales are sold outside the network and how much are consumed within the distributor base?

(A): So, David, we have a 70% custom rule which is basically says that 70% of all products sold to consumers or actually consume my distributors for their own personal use. So obviously what we've seen with nutrition clubs is that we now have visibility for the first time to our customers. We know that we reported on this call for the first time the number of commercial clubs around the world, which is in excessive of 30,000, so that has given us feasibility to the tremendous amount of products that are being sold directly to the consumers and we see that as a growing trend in our business.

(Q – David Einhorn): So, what is the percentage that actually sold to consumers that are not distributors?

(A): So, we don't have an exact percentage David because we don't have visibility to that level of detail.

That the answers offered by the MLMs make no sense in business terms leads to the obvious consideration of a non-business explanation, i.e., fraud. Readers may notice that the *who-is-buying-and-selling-and-how-much* question to be the very same one asked of Charles Ponzi and Bernard Madoff, both of whom pretended that they were generating profits from *external* trades to pay investors, when in fact they were just transferring the investors' own money within a closed-market fund. In 1920 Boston, Ponzi claimed he was trading international postal coupons with his investors' funds and generating extraordinary profits. But, legendary financial analyst and newsman, Clarence Barron concluded there were not nearly enough of such coupons in existence to generate Ponzi's alleged profits. Similarly, Wall Street whistle blower Harry Markopolos concluded in 2008 New York City that it was mathematically impossible for Madoff to make enough profitable trades to consistently generate 12% profits for all his investors every year. As it turned out, the coupon and stock trading of those two swindlers did not exist.

That the answers offered by the MLMs make no sense in business terms leads to the obvious consideration of a non-business explanation, i.e., fraud.

Now, the world is asking for evidence of retail trades by the MLM companies. If there are little or no retail trades occurring, then the funds paid as "commissions" must only be transfers from the investments of the newest recruits. The only funds available to make payments to any one inside the MLM chain are the MLM investors' *own money*. And, the only hope for the latest MLM investors who sign sales contracts to gain a profit is to extend the chain further, *ad infinitum*.

Testing for Retail

Companies	ALL Distributors in USA	Total Revenue in USA	Average Annual Purchases per Distributor	Maximum Possible Gross Retail Profit p. Distrib. at 30% Retail Profit (before all selling costs, discounts, samples, and self consumption)
Amway	743,500	$1.2 Bil	$1,614	$13.30 p. wk.
Nu Skin	193,826	$242 Mil	$1,249	$10.29 p. wk.
Herbalife	493,862	$816.9 Mil	$1,654	$13.63 p. wk.
Total	1,431,188	$2.259 Bil	$1,578	$13 p. wk.

Before concluding that the business model of the three MLMs examined in this study operate as closed-markets, employing fixed prices, retraining trade, preventing competition and employing an endless chain promise, the data on *possible* external revenue from retail sales should be reviewed, even if the MLM companies themselves do not document such sales and no longer argue that they occur.

Just as the MLMs do not reveal who exactly the "customers" are *inside* the chain or how much each sector buys, they also do not identify or quantify non-contract end-users, that is, what would be conventionally understood as retail customers. Could the distributors be successfully retailing, notwithstanding the MLM claims that more than two-thirds of the distributors have no interest in making a profit?

There is no data available on numbers of retail customers, average retail profit margins or average retail sales volume of the distributors. However, the data do provide the aggregate amount that all the distributors *purchase*. This figure represents the total amount that *could be* retailed. The data also offer the total number of distributors. A calculation can therefore be made as to what the maximum possible retail profit the distributors could gain, *on average*. That number is $13 a week. This is the maximum, per capita that could be gained if no products were ever self-consumed, given away, or discounted when retailed. It is based on a generous potential retail profit of 30%.[8]

In sum, the data show there is no potential for a viable retail profit margin. The retail sales opportunity does not exist.

Testing for a Closed Market and Saturation

Accepting the MLM claim that it has no legal or economic need for external retail sales because its *own sales channel* is also its customer base requires accepting the corollary. It is that inside the channel, absent external retail sales, *some* resellers in this sales/customer channel really are in it for the money, but the *vast majority* are not in the least interested in the income opportunity. Among this huge group, purchases or any other costs incurred such as signup fees are totally unaffected by the contract terms or the income incentives available to them. Their *lack of interest* accounts for their lack of income, nothing else.

Could it be true that all this money is just left on the table because the vast majority of those who sign up have no interest in what is often characterized by MLM promoters as the "greatest income opportunity in the world"?[9]

Fortunately, there is a simple calculation that can be applied to test the MLM companies' claim of knowing the inner hopes and intentions of its distributors. The premise that all who *want* to succeed *can and do* succeed, can be tested by just asking, *What would happen if more* who signed up "tried"? Could the market support a higher level of "success"?

To make this test, the MLM industry's "reverse engineering" logic that *defines* losers as quitters and quitting as the *cause* for losing, is set aside. Instead, an objective test is

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[8] Maximum Possible Gross Retail Profit, on average, is determined by first factoring the average per capita purchases of $1,578 (total revenue divided by total number of distributors). 30% retail profit on these average purchases equates to a 43% mark-up. Average annual purchases of $1,578 sold at a 30% retail profit would factor to total retail sales of $2,254 or a gross retail profit of $676 per yr., or $13 per week, per distributor.

[9] The claim that Amway is "the greatest income opportunity in the world" is commonly repeated and similar claims are made by other MLMs routinely, in support of the even bigger claim that MLM itself is unique and fundamentally different from conventional business, effectively an alternative economy. In a class action lawsuit brought against Amway by Canadian distributors, the claim was specifically cited,

> *"At all material times, Defendants represented to the public that IBOs could earn substantial compensation by distributing their products. For example, over the last two years, the Defendants made the following representations publicly to all prospective participants: i) Amway is "the greatest business opportunity in the world"; as appears from an excerpt of The Amway Global Business Opportunity Brochure … In fact, at all material times during the class period, the overwhelming majority of all distributors have shown a net loss after expenses, a fact long known to the Defendants. As such, the average compensation of the smallest range of compensation earned by over 50% of the IBOs is negative and it follows that the overwhelming majority of distributors earn significantly less than what was represented to them."* (http://www.amwaywiki.com/images/b/b6/Cheryl_Rhodes_and_Kerry_Murphy_vs_Amway_Canada_-_Complaint.pdf)

employed that does not make a judgment on the character or the intentions of participants, and requires no reading of their minds and hearts. It just asks the simple question whether the business model and the marketplace could support a higher rate of success?

This approach of questioning the legality and viability of the model – not the character of the participants – is more than reasonable; it is unavoidable. It has already been statistically demonstrated that 99.6% who join the model don't earn a net profit, on average each year, while those few at the very top are making six figure incomes, on average, with some making millions. That is a obvious red flag. But, the numbers are actually far worse than a 250 to 1 average loss rate. If the top 0.4% are presumably a stable group, operating year to year, and the majority of the entire chain churns at rates of 50-90% a year, then the true percentage of successful resellers *seen over a multi-year term*, falls far below statistical significance. The "income opportunity" may be stated at non-existent.

The three MLMs have about one of out of every hundred households in America already under contract. There are only 99 households in total that remain in America for each participant to enroll before the entire population of America is on the chain.

If it is that the losers were recruited into a closed market and met the wall of market saturation, their losses are known in advance by the top recruiters, pre-determined, inevitable, and serve the business model as the only source of what are later called "profits" of the "winners."

A closed-market analysis of this report's data starts with the baseline data point of 1.4 million contractors all purchasing goods at a per capita rate of approximately $1,600 per year. Some participants undoubtedly purchased more than others. But the *collective* purchases of all the participants constitute the total market and total funding source for any rewards that are paid. There is no measurable external income source. The MLM fund is effectively closed. Therefore it is impossible for anyone who contributed to the fund with purchases and fees and shipping costs, etc., to gain more than what he/she put in other than through a "transfer" of funds from some others on the chain. Income for some must mean loss to some others.

Correspondingly, there is no way for *more people* on the chain to gain rewards at any given time without causing more losses to some of the others, *except by extending the chain's length,* that is to add more members. Since the MLM sales channel, on average, loses participants at a 50+% rate through attrition (losers that quit), then the later recruits must not only find new participants but also replace those that leave.

- As a group, the three MLMs in this study, collectively, already have about one of out of every hundred households in America under contract.[10]
- There are only 99 households in total that remain in America for each participant to enroll before the entire population of America is on the chain.

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[10] The Census Bureau counted 115,226,802 household in the USA in 2012. The three companies had 1.4 million distributors. (http://quickfacts.census.gov/qfd/states/00000.html)

- The successful 5,500 at the top of the chain have about 250 members in their personal downlines on average in the USA each year. Some have thousands more internationally that feed into their high commissions.
- If just 20% of the bottom 99.6% each recruited just 5 others, the ranks of the chain immediately double. If 20% of the newly enlarged chain repeated the process it would double again. In two cycles of just 20% recruiting a modest 5 others, the channel of 1.4 million would swell to over 5.5 million, leaving only about 25 households per distributor to recruit or sell to. And so on.

Quitters Sustain the Pyramid

Obviously, such an apparently modest realization of the advertised business plan of "just find five" cannot occur due to current market saturation. The promise of income is a promise the model cannot deliver. Massive "quitting" rates are the outcome of an impossible expansion mandate. Quitting is not a function of "failing" or "not trying." It is the life-blood of the business model. Collapse must occur *annually* or the entire chain would collapse *totally*. The quitting rates are necessary to prevent complete meltdown. It allows a *continuous* collapse to occur while *continuous* recruiting resurrects the chain simultaneously, creating an illusion of sustainability *for the enterprise*. But for the hundreds of thousands of new recruits quitting (collapse) becomes their inevitable option, and virtually all take that option within a year or two. They did not lose because they quit. They lost because they *joined*.

They did not lose because they quit. They lost because they joined.

The Illusion of Sustainability

The model is unsustainable *for new recruits to be profitable* and it can *never* deliver its income promises to more than a fraction of 1% for as long as it operates. However, if the MLM can successfully replace the 50+% of "quitters", the *MLM itself* can *appear* sustainable, for a long while. It does this by offering everyone the electrifying but utterly impossible income offer based on unlimited expansion. It supports that deceptive claim by withholding relevant information, offering misleading "testimonials, deceptive claims that it is possible for all to succeed and then by convincing those that fail, the losses are their "own fault." (*Only quitters lose*).

The collective effort of all 1.4 million, composed of millions of individuals' *futile* efforts, produces enough new recruits, aggregately, to replace the "failures". The churning process continues year after year.

Even with the illusion of "sustainability" created by hopeful and zealous new recruits replacing the disgraced "quitters and losers", these MLM schemes are marching toward oblivion, as they leave near 100% loss rates of new recruits in their wake, never to return. Existing territories will eventually be depleted. They will not be able to show the critical appearance of "momentum" unless fresh new territories are found, or new population sectors are exploited in existing territories. In the USA, for all three companies, China is that new market, especially for Nu Skin and Amway[11], while low income Latinos, many undocumented, unable to speak English and some financed with subsidized "micro-credit loans" keep domestic recruiting alive for Herbalife. But the time bomb is ticking.

The Image Finally Emerges

This report's painting-by-the-dots data compilation and analysis did not reveal a recognizable *business* model. It did however, uncover a closed-market, endless chain scheme. The data show that the three MLMs under study long ago reached saturation of the USA market. All three companies sell similar goods – health/weight loss/cosmetics. They make the same income promise, use the same model, and each one prohibit its own distributors from joining the others while under contract, revealing that they all competing for the same recruits/investors. The investments of the bottom 99.6% are the source for these "commissions" that concentrate at the very peak.

This pyramid, closed-market model is fatal to most new recruits within a year. Virtually all of them quit within a year or two. MLM's classic top-loaded pay plan that siphons 54% of all rewards to the top 0.4% *accelerates* this churning process. The punishing requirement for maintaining purchase/sales levels results in the commissions that are owed to recruiters getting passed up to the top when they inevitably quit. The special bonuses and awards for the highest "group" volume producers, the top .4%, pull a huge chunk out of every available commission dollar, sending them directly to the top.

There is no evidence of any other income source other than the participants' own purchases. Therefore, the only way the newest recruits into the MLM market can recoup investment and gain reward is to attempt to expand the chain further in order to have the latest entries' money transferred to them. It is *ultimate* impossibility of the endless chain proposition that makes it *inherently* fraudulent. As the chain proceeds toward saturation, which can occur very soon after it is launched, the percentage of those in the bottom ranks is established and never varies. They are always the vast majority. Thus, for as long as the scheme operates, long before ultimate meltdown might occur, that percentage – the vast majority – are destined to fail, *by design*. Quitting is not a failure scenario for millions of recruits. It is an escape.

[11] Amway reports that 41% of all its sales in the world are now in China. (http://www.chinadaily.com.cn/business/2014-02/19/content_17290610.htm)

Nu Skin sales in China, including Hong Kong and Taiwan more than tripled in the 3rd quarter of 2013 over the previous year and accounted for the bulk of the company's total revenue gain for the quarter. "Mainland China alone accounted for 30 percent of Nu Skin's $2.16 billion in revenue during the first nine months of 2013." (http://www.bloomberg.com/news/2014-01-21/nu-skin-to-review-practices-in-china-after-pyramid-claim.html)

"Hispanics account for up to 60 percent of Herbalife's sales in the U.S. and their involvement in this home-based business seems to be growing," (http://latino.foxnews.com/latino/money/2013/02/20/herbalife-under-fire-for-alleged-pyramid-scheme-owes-success-to-latinos/