

How to Tell if a Direct Selling Company is a Pyramid or a Legitimate MLM

By Jeffrey Babener © 2013 / 2014

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This article is the companion piece to the video: [How to Tell if a Company is a Pyramid or a Legitimate MLM](#).

You may have been recruited for a network marketing opportunity or you are a recruiter. Inevitably, this question will come up, is the company a pyramid scheme or a legitimate business opportunity?



Although this is a complex legal area, let me share a simple metaphor that draws a clear line in the sand.

The metaphor is about a gentlemen, will call him Party #1, and he sells a case of canned tuna fish to Party #2 for \$10. And, Party #2 sells it to Party #3 for \$20, and Party #3 sells the case of canned tuna fish until it gets to Party #10, who buys the case of canned tuna for \$500. And, Party #10 opens up the case of tuna fish and it's rancid. It's inedible.

He goes back to Party #9 and complains, "I bought this case of tuna for \$500 and it's rancid." Party #9 tells him to take it to Party #8, and Party #8 tells him to take it to Party #7, and so on until Party #10 goes all the way back to Party #1 and says, "You're the one who started all of this! I have a problem!"

And, Party #1 asks, "What's your problem?"

Party #10 says, "Well, I bought this tuna fish, I opened it up, it's rancid. It's no good!"

Party #1 asks, "Well, what's your problem?"

Party #10 says, "Don't you understand? It's rancid. How am I going to sell this?"

And, Party #1 says, "Well, you don't have a problem."

Party #10 answers, "What do you mean I don't have a problem?"

And, Party #1 says, "You don't understand, this tuna is for selling, not for eating."

If you think about that metaphor, it may help explain the difference between a legitimate company and a pyramid scheme.

And, there lies the difference. Distributors in a network marketing program that are merely buying product to buy into the “deal” as opposed to having the intention of really making a market for the product, are really working a pyramid scheme, not a legitimate direct selling business. Remember, when you offer the opportunity to your next door neighbor or your best friend, it’s your credibility that’s going to be on the line for years to come.

So, what do you look for with respect to legitimacy versus pyramid schemes? Here are nine pyramid scheme checklist items that you should consider:

1) **Product and Price** – Does the company offer a high quality product for which there is a strong demand in the real world marketplace? Is the product fairly priced and priced competitively with similar products? Can the product be demonstrated and does it stand out when you show it to friends? Is the product proprietary to the company and available only through its distributors? Ever notice how you can’t buy Avon products in stores or Shaklee vitamins at pharmacies? Is it backed up with a customer satisfaction guarantee? Is post-sale service or customer assistance available? Do the people who participate in the program buy the product enthusiastically based on its own merits even if they don’t participate in the compensation program?

2) **No investment Requirement** - Can you participate in the company’s program without having to make any investment other than purchasing a sales kit or demonstration material sold at company cost?

3) **Purchase and Inventory Requirements** – Can you become a distributor or sales representative without having to fulfill a minimum purchase requirement or inventory requirement? When you are pitched to purchase thousands of dollars in inventory then you should run fast in the opposite direction. Does the company’s compensation plan discourage inventory loading? Garages and backrooms filled with products of no useful purpose to anyone.

4) **Sales Commission Sources** – Are sales commissions paid only on actual products/services sold through distributors in the network to the end user or ultimate consumer? This means that products don’t end up in basements and closets. They are used because they have a genuine value. Does the compensation plan avoid paying commissions or bonuses for the mere act of sponsoring or recruiting? If it pays headhunting fees, it is illegal.

5) **Buyback Policy** – Will the company buy back inventory and sales kit materials from distributors who cancel their participation in the program as long as these items are in resalable condition? This policy is required in states which have adopted multi-level distribution statutes.

6) **Retail Sales** – Is there an emphasis on actual retail sales to end consumers, that is, to people who are not participating in the distribution program? Can the company demonstrate efforts to market products to the ultimate consumer? Do the company’s distributors have ongoing retailing requirements to qualify for commissions?

7) **Expect an active and not a passive role for distributors** – Are distributors in the company required to actively participate in the development and management of their networks?

8) **Earnings Misrepresentations** – Do the company’s literature and training materials scrupulously avoid claims of income potential? The Federal Trade Commission, attorneys general and postal inspectors all have their eyes on the matter of earnings representations. The acceptable approach emerging is that there should be no earnings representations unless they are based on a verifiable track record of the average earnings of distributors. For instance, a company should have statistics to show the percentage of active distributors and the average earnings of active distributors.

9) **Good Training** – Does the company offer its independent distributors solid training opportunities in sales and recruitment? Are different levels of training offered to match the increasing levels of experience and responsibilities of distributors?

Is this the end of your journey? *Obviously not.* You’ve looked at some legal issues, and now it’s time to move on to some solid business analysis, but it’s a great start.

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[MLM Pyramid Schemes – Everything You Need to Know All in One Place](#)

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This article is also available online at: <http://mlmattorney.com/blog/2013/02/28/how-to-tell-if-a-direct-selling-company-is-a-pyramid-or-a-legitimate-mlm/>

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On Assignment

On any given day you can catch [Jeffrey Babener](#) lecturing on Network Marketing at the University of Texas or the University of Illinois, addressing thousands of distributors in Los Angeles, Bangkok, Tokyo and Russia, or writing a new book on Network Marketing, an article for Entrepreneur Magazine or a chapter for a University textbook. Over two decades he has served as marketing and legal advisor to some of the world's largest direct selling companies, the likes of Avon, Nikken, Melaleuca, Discovery Toys, NuSkin, and he has provided counsel to the most successful telecom network marketing companies...Excel, ACN, World Connect, ITI, AOL Select and Network 2000. An active spokesperson for the industry, he has assisted in new legislation and served on the Lawyer's Council, Government Relations Committee and Internet Task Force of the Direct Selling Association (DSA) as well as serving as General Counsel for the Multilevel Marketing International Association. He is an MLM

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