

Appendix B

**Unmet Challenge to Network Marketing (MLM) Industry Leaders:
Network Marketing Payout Distribution Study**

The “Network Marketing Payout Distribution Study” includes:

- (1) the letter to the presidents of 60 of the most prominent network marketing companies (below)*
 - (2) conclusions about network marketing (MLM) the company presidents were invited to disprove, at least for their companies*
 - (3) the forms which—if completed—would tend to prove or disprove such conclusions*
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CONSUMER AWARENESS INSTITUTE

Spring, 1999

ATTN: _____, President

Company

Address

Dear Mr./Ms. _____:

For the past two years I have researched the field of network marketing (MLM—a.k.a. “MLM”) and have interviewed hundreds of people who had been involved in a wide variety of programs. My research, while initially positive, uncovered more and more very unsettling problems with MLM.

When speaking on the subject of MLM to local groups I have received much feedback from participants and critics of MLM. One tax accountant who was a principal of H&R Block in northern Utah stated that over the years he and his staff had prepared thousands of tax returns, and of the several hundred of these who he knew had been involved in MLM, he could remember only one who had ever reported a net profit on his return.

Though I already knew that the actual success stories were far less than one would be led to believe from attending a typical MLM opportunity meeting, this tax man’s report was shocking to those of us who heard it. So I called tax accountants and preparers in other areas to see if their experience was the same. Each of them claimed similar experiences with their clients over the years. Others who work with peoples’ money, such as certified financial planners, insurance underwriters, and bankers, have relayed similar feedback.

I will soon be publishing this information for the benefit of consumers, educators, legislators, and regulatory agencies who have an interest in this topic. The page that follows presents the essence of my conclusions, which unfortunately are not favorable for the MLM industry. So I felt it only fair to allow for rebuttal from you and others who may have an interest in seeing a balanced treatment of the subject. So I am offering you that opportunity and the format for doing so.

Your assistance in gathering objective information will be greatly appreciated. I am not interested in anecdotal material, which may be no more valid than stories of persons who won a lottery or a sweepstakes. And vigorous arguments to the contrary will not help—I believe I’ve heard them all. What will carry weight is data which breaks down the distribution of payouts to your distributors, extracted from your data base of distributors. The information you provide must be verifiable by independent audit, as consumer protection agencies and legislators may choose to validate this material. Following this letter are instructions for providing the information.

You should be able to access this information readily from your database. However, if you prefer not to provide this information because it won’t reflect well on your program, I can certainly understand your reluctance. But such refusal will be interpreted to be an answer in itself. I shall be looking forward to your response.

Appreciatively,

Jon M. Taylor, Ph.D.

NETWORK MARKETING PAYOUT DISTRIBUTION STUDY

By Jon M. Taylor, Ph.D.

A. Network marketing has wide appeal.

Network marketing (MLM—a.k.a. MLM) offers the opportunity for an individual to conduct a business without having to bother with expensive resources such as physical plant or retail storefront, warehousing, employees, advertising, or other costs typically associated with running a business.

With MLM, large (leveraged) incomes can be produced by recruiting a downline (network) of multiple layers of distributors upon which a distributor can draw commissions and bonuses, the amount depending on the type of compensation plan and the size and character of one's "downline." Such an organization can be built from one's own home without the expenses and complications typically associated with other types of businesses.

MLM offers not only financial independence with minimal investment, but a level playing field in which anyone can participate, regardless of sex, age, education, or financial resources. Other advantages include the social benefits and recognition of building one's own organization and the backing of a MLM company which provides the products and infrastructure necessary for success.

B. Network marketing poses problems for most participants, resulting from pyramidal concept, motivation, and effects.

When the Federal Trade Commission ruled in 1979 that Amway was not an illegal pyramid scheme—mainly because legitimate products were offered, the floodgates were opened and multi-level marketing programs began to proliferate. But what is often ignored is the fact that MLM programs are still pyramid schemes, modified by a variety of compensation systems that change the character of the pyramid, but not the essential pyramidal concept, motivation, and effects.

The pyramid concept in MLM is seen in multiple layers of distributors, with lower level distributors contributing income to an "upline" who may have little to do with a given sale. This is distinguished from the typical retail scenario in which a retailer may get two or three times the return per sale as the wholesaler, whereas with MLM the upline distributor may get as much or more of a return per sale (in commissions and bonuses paid by the company) as the front line distributor who actually sells the product.

Because MLM compensation systems reward front line distributors only a small commission (usually less than 10%) for selling product, recruiting to gain income from downline distributors is vital to earning a significant

income. This is distinguished from other direct sales programs, in which the person selling and servicing the product typically keeps from 20% to 50% of the sale—enough incentive to concentrate on the end user as a valued customer.

The motivation of most MLM is the opportunity to make large amounts of income for a minimal investment of time and money. One of the primary appeals of MLM is the concept (touted at MLM opportunity meetings) of "time freedom" or "leveraged income," which allows a person to gain an income flow from the efforts of others without having to work directly for one's own income. But because of MLM compensation systems, this requires success at recruiting a downline, more than on selling the products directly.

Critics complain that many MLM distributors place too much emphasis on the "opportunity" as opposed to the product, thus blurring the distinction between the product and the opportunity. As I mentioned, this can be accounted for by the reward structure of MLM compensation systems, which benefits primarily top upline distributors—who may receive extremely large commissions from their aggregate downline. An inordinate appeal to greed often becomes the primary motivation.

A most troubling aspect of MLM is its effects on people. Because the compensation systems are heavily weighted to reward upline distributors for their recruitment efforts and because of the pyramidal nature of these systems, extraordinary income differentials are created between upline and downline distributors. In fact, after deducting expenses for building and maintaining a network, only a tiny fraction of MLM distributors ever report a positive income on their income taxes. And if products purchased from the company (that likely would not have been purchased were they not participants in the program) are subtracted, perhaps less than one out of 100 distributors earns more than a minimum wage for their efforts. A high percentage of distributors lose money—much higher than most other legitimate business and income pursuits. Careful examination of most MLM programs reveals a pattern of exorbitant incomes accruing to relatively few top distributors at the expense of hundreds and even thousands of downline distributors who—even with diligent effort—come away empty-handed. In this respect MLM is akin to illegal pyramid schemes.

It is interesting to compare the odds of success of MLM schemes with legalized gambling in Nevada. It appears that on average one could do better at most any of

the gaming tables or slot machines in Las Vegas—without investing all that time and placing valued relationships at risk.

Some zealous MLM distributors will mortgage their homes or max out their credit cards (buying MLM products and other expenses) to finance their ambition to achieve top levels in their organization—which is seldom achieved. Others focus so much on recruiting to meet escalating volume requirements for higher distributor levels that they ignore the needs of spouse and family members.

Sometimes the recruiting practices of MLM distributors are deceptive and overbearing. Often MLM distributors will alienate friends and family members they endeavor to recruit for what seems to them a self-centered pursuit of a vaporous dream.

C. Summary and invitation for rebuttal

In summary, with network marketing, what appears on the surface to be a fair and enabling marketing system for participants is in reality a legalized pyramid scheme with characteristics of concept, motivation, and effects similar to those of an illegal pyramid scheme.

You are invited to prove me wrong—at least for your company. This can best be done by providing full disclosure on payout distribution to your distributors on the attached form. For the purposes of this study, this information must be broken down by percentiles, not by distributor level.

Please note that I am not asking you to reveal sensitive information, such as individual distributor incomes or even your annual profits, which you may wish to keep confidential. It is average payout to distributors by percentiles (as indicated on the attached form) that will satisfy the objectives of this study for the benefit of consumers.

Please also note that I am offering two options for your response—an easy one (Option A) and a more comprehensive one (Option B). It is assumed that Option A could be competed quickly and easily from your existing accounting system.

Option B requires a more extensive breakdown, but would offer to those interested more conclusive evidence that your company does or does not base its compensation to distributors on a pyramidal structure, as discussed above. For the purposes of this study, Option B would be much preferred, if you can return such data to us within a month or so.

We are not making any assumptions about how much effort was put into any given MLM program or compensation system, as it relates to success or failure of any specific distributor or program. So it is important that all participants in your MLM program for the year be included, even those who only bought a distributor starter kit or set of samples—whether or not they have done anything with it.

Please mail completed form to:

MLM Payout Distribution Study
Consumer Awareness Institute
P.O. Box 488
Kaysville, UT 84037

OPTION A: Distribution of Payout to Distributors for the Most Recent Fiscal Year Beginning _____ and Ending _____

Company name _____ Contact person _____ Tel. no.(_____)_____

Address _____

City, state, zip _____

Please check (✓) one:

- a. We are willing to provide the information below and have it made available to the public.
- b. We are providing the information below with the understanding that it may be used for compiling industry statistics but not identified with our company in published reports.
- c. We are not willing to provide the information requested. We realize that in refusing to do so we may be tacitly conceding the conclusions drawn in the preliminary two-page report, entitled, "Network Marketing Payout Distribution Study."

If you are interested in receiving information on the completed report when it is done, please check here _____ (This research report is to be sold for a reasonable price—yet to be determined—to recover costs.)

Important instructions: For purposes of analysis, distributors are to be broken down by distributor payout percentiles, not company-established distributor levels. Also, it is important that every person who has enrolled as a distributor (i.e., purchased starter kit or samples, or signed a distributor agreement) be included in these statistics, including those who have not sold anything or quit, even after one day.

Percentile break-down in payouts to distributors (by percentile, <u>not</u> distributor level)	Total number of <u>all</u> of your distributors at <u>this</u> payout level	Ave. total payout per distributor (all commissions and bonuses paid by the company, but <u>excluding</u> retail margins)	Less: average total dollar amount per distributor of product purchases from your <u>company</u>	Average net payout* per distributor (after deducting cost of <u>product</u> purchases)
Top 1/10 of the top 1% of distributors	_____	\$ _____	\$ _____	\$ _____
Bottom 9/10 of the top 1% of distributors	_____	\$ _____	\$ _____	\$ _____
Next 9/10 of the top 10% of distributors (the 2nd to the 10th percentiles)	_____	\$ _____	\$ _____	\$ _____
Bottom 90% of distributors	_____	\$ _____	\$ _____	\$ _____

(Total 100%)

*It is recognized that income reported here does not take into account costs to distributors for conducting their MLM business. Such costs may include, travel, postage and shipping, long distance and other telephone costs, advertising, rental of meeting rooms and/or office space, fees for company conferences or retreats, supplies, sales materials, and other expenses.

THANK YOU FOR YOUR HELP!

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**OPTION B: Distribution of Payout to Distributors for the Most Recent Fiscal Year
Beginning _____ and Ending _____**

Company name _____ Contact person _____ Tel. no.(_____) _____

Address _____

City, state, zip _____

Please check (✓) one:

___a. We are willing to provide the information below and have it made available to the public.

___b. We are providing the information below with the understanding that it may be used for compiling industry statistics but not identified with our company in published reports.

___c. We are not willing to provide the information requested. We realize that in refusing to do so we may be tacitly conceding the conclusions drawn in the preliminary two-page report: "Network Marketing Payout Distribution Study."

If you are interested in receiving information on the completed report when it is done, please check here _____ (This research report is to be sold for a reasonable price—yet to be determined—to recover costs.)

Important instructions: For purposes of analysis, distributors are to be broken down by distributor payout percentiles, not company-established distributor levels. Also, it is important that every person who has enrolled as a distributor (i.e., purchased starter kit or samples, or signed a distributor agreement) be included in these statistics, including those who have not sold anything or quit, even after one day.

Percentile breakdown In payouts to distribu- tors (by percentile, not by distributor level)	Total no. of <u>all</u> distributors at this payout percentile	Ave. total payout per distributor (all commis- sions & bonuses paid by the company, exclu- ding retail sales	Less: average total dollar amount per distributor of product purchases	Average net payout per distributor (after deducting cost of product purchases
First 1/10 of the top 1% of distributors	_____	\$ _____	\$ _____	\$ _____
Second 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Third 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Fourth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Fifth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Sixth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Seventh 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Eighth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Ninth 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____
Bottom 1/10 of the top 1%	_____	\$ _____	\$ _____	\$ _____

After breaking down average payout per distributor for the top 1% by tenths of a percent, please break down the next 9% by whole percentiles:

Percentile breakdown In payouts to distribu- tors (by percentile, not by distributor level)	Total no. of all distributors at this payout percentile	distributor (all commis- sions & bonuses paid by the company, exclu- ding retail sales	Less: average total dollar amount per distributor of product purchases	Average net payout per distributor (after deducting cost of product purchases
Second 1%	_____	\$ _____	\$ _____	\$ _____
Third 1%	_____	\$ _____	\$ _____	\$ _____
Fourth 1%	_____	\$ _____	\$ _____	
	\$ _____			
Fifth 1%	_____	\$ _____	\$ _____	\$ _____
Sixth 1%	_____	\$ _____	\$ _____	\$ _____
Seventh 1%	_____	\$ _____	\$ _____	\$ _____
Eighth 1%	_____	\$ _____	\$ _____	
	\$ _____			
Ninth 1%	_____	\$ _____	\$ _____	\$ _____
Tenth 1%	_____	\$ _____	\$ _____	\$ _____

After breaking down average payout per distributor for the top 10% by whole percentiles, please break down the next 90% in groups of 10% each:

Percentile breakdown In payouts to distribu- tors (by percentile, not by distributor level)	Total no. of all distributors at this payout percentile	distributor (all commis- sions & bonuses paid by the company, exclu- ding retail sales	Less: average total dollar amount per distributor of product purchases	Average net payout per distributor (after deducting cost of product purchases
Second 10% (11-20%)	_____	\$ _____	\$ _____	\$ _____
Third 10% (21-30%)	_____	\$ _____	\$ _____	\$ _____
Fourth 10% (31-40%)	_____	\$ _____	\$ _____	\$ _____
Fifth 10% (41-50%)	_____	\$ _____	\$ _____	\$ _____
Sixth 10% (51-60%)	_____	\$ _____	\$ _____	\$ _____
Seventh 10% (61-70%)	_____	\$ _____	\$ _____	\$ _____
Eighth 10% (71-80%)	_____	\$ _____	\$ _____	\$ _____
Ninth 10% (81-90%)	_____	\$ _____	\$ _____	\$ _____
Bottom 10% (91-100%)	_____	\$ _____	\$ _____	\$ _____
(Total 100%)				

*It is recognized that income reported here does not take into account costs to distributors for conducting their MLM business. Such costs may include, travel, postage and shipping, long distance and other telephone costs, advertising, rental of meeting rooms and/or office space, fees for company conferences or retreats, supplies, sales materials, and other expenses.

THANK YOU FOR YOUR HELP!

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