



## **How can Multi-level Marketing business model be successful**

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## 1. Abstract

The purpose of the research was to find common features of MLM companies that all successful network marketing companies share. And establish success requirements an MLM model-based company has to fulfil to become sustainable over a long period of time.

## 2. Introduction

MLM and a Pyramid schemes have a similar structure, but they are based on different commission plans and concepts of selling, that results in legitimacy and illicitness, respectively of their business models. However, legitimacy does not imply successfulness and subsequently incorporating MLM as a business model should be executed properly to gain a profit.

Legally the main difference between MLMs and pyramid schemes is that MLM companies make money by selling products or services while pyramid schemes make money by selling right of recruiting. Therefore, the difference between MLM and Pyramid schemes should be clearly understood, and correct guidelines established for MLM to be legal and profitable.

We examine 5 successful MLM Companies (Avon, Tupperware, Amway, Mary kay Cosmetics and Herbalife) and summarize their strategies to understand what makes them successful and how they use network marketing to sustain business. Subsequently, we establish certain principal requirements for MLM business model to be successful in the long run.

## 3. MLM vs Pyramid Scheme

Multi-level Marketing (MLM) also called network marketing is a direct selling method through a pyramid structured network of distributors. People recruited as independent distributors sell company's products or services. These distributors recruit distributors of their own. They earn commission on their own sales revenue and on the sales revenue of their downline recruits, who are below them in the structure. The main focus is on recruiting downline and selling as much as you can to earn more commission.

A network marketing business model based on hierarchical setup of compensating distributors primarily for recruiting downline rather than for selling the company's products and services is considered to be an illegal pyramid scheme<sup>1</sup>. Companies with pyramid scheme model have money making strategies promising large profits but as recruiting multiples, it becomes impossible to recruit and participants are at a loss.

In summary, not all MLM structures are *pyramid schemes*<sup>2</sup>. A *pyramid structure*<sup>3</sup> considered legally viable has to be based on making profits from the sales of products and not from recruiting new distributors.

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<sup>1</sup> Valentine, Debra A. "International Monetary Funds Seminar on Current Legal Issues Affecting Central banks". Federal Trade Commission. 05/11/2018

<sup>2</sup> A usually illegal operation in which participants pay to join and profit mainly from payments made by subsequent participants. Merriam Webster Online. 09/11/18

<sup>3</sup> Something arranged in a pyramid pattern of organization

## 4. Successful MLM Companies

### Avon

Avon was founded in 1886 by David H. McConnell as a direct selling company of highest quality beauty and household products. It has been around almost a century and a half and with the annual revenue of \$5,72 billion it is a perfect example of a successful multi-level marketing business.

Avon business model is based on a pyramid-like structure, similarly as other MLM models, but it is not a pyramid scheme, the money one makes is not affected by one's position on the pyramid. Avon provides an earnings opportunity, so individuals can achieve financial independence and enjoy all that comes with such an accomplishment.

There is three ways to earn: direct selling that is 20-40% of commission on sales plus an additional 5% to top sales consultants each month, online selling with similar commission structure and recruiting for the company that is bonus and commission of 2-12% on the total sales of team depending on where recruit is located and if the qualifications are met.

Avon motivates, inspires and encourages all distributors treating them to rewards when a specific goal is achieved, recognizing their unique contributions. This gives incentive to others to join the company.

Moreover, Avon is involved in philanthropic causes dedicated to women's causes globally. With Avon Foundation for Women established in 1955, it gives back to the communities it serves.

### Tupperware

Tupperware was founded in 1948 by Earl Tupper. It manufactures and distributes kitchen and home – preparation, storage and serving products; with around \$2,3 billion in annual revenues.

Tupperware sells products to retail customers as well as to direct consumers. Usually the sale happens at parties that Tupperware distributors organize, as well as customized Web site and TAP locations. The products are of a high quality and last for a long time thus the products do not need to be replaced regularly. Because of this, Tupperware distributors do not have regular customers and they need to constantly prospect new ones.

The core value of the business is based on making sales. The consultants know that to be successful they need to sell lots of products. They earn up to 35% commission on their personal sales (25% personal profit and monthly personal sales volume bonus of 5-10%), plus percentage bonuses from the sales made by any new member recruited. There is also option of receiving Tupperware manager vehicle program for qualified managers for no cost or insurance premia.

### Amway

Amway was founded in 1959 by Jay Van Andel. The multi-level marketing company of beauty, health and home care products which is another example of successful network marketing model that has been around 60 years with an annual revenue of \$8,6 billion. The main idea was to sell basic products that every individual needed in American way (hence the name Amway).

The product was marketed in a specific way that spoke to people. The first product was an organic detergent that was not chemical as all the others available on the market and benefited the earth. Amway exhorted a view that it cared about the nature and during the period of 60-70s with hippie movement this view supported people's lifestyle and intentions.

The distributors of Amway products earn by the 'basic discount' difference between the price paid by the distributor for the product and the price charged by the distributor at retail, that is around 30% of the margin. There are additional bonuses when an individual meets a certain amount of production. And there is a predetermined career path with corresponding steps to achieve and payroll system.

## **Mary Kay**

Mary Kay was founded about 55 year ago in 1963 by Mary Kay Ash. It has \$3,5 billion annual revenue and operates with one "golden rule" that requires employees and distributors to treat one another as they would themselves like to be treated. Even though with very successful business for Mary Kay work and career came third in importance compared to God and a family: "God first, family second, career third".

The focus of Mary Kay members is on what they can give to others and the success will take care of itself. Mary Kay utilized independent businesswomen by recruiting a sales force independent of the company, now it sells products at whole sale price to more than 250000 independent consultants in a worldwide network.

There are many benefits for consultants that consists of 50% profit on all products sold; an additional 4, 9, 13 or 26% commission on sales by the team's downline, depending on the number of levels downline; free use of Mary Kay cars; and some additional rewards of all-expense paid vacations, diamond rings, and diamond bumble bee pins.

Similarly, to Avon they also are active in several diverse philanthropic organizations particularly, to find cure for cancer.

## **Herbalife**

Herbalife nutrition is a multi-level marketing corporation that was founded in 1980 in Los Angeles by Mark Hughes, that sells weight management, nutrition supplements, personal care and sport nutrition products. Its annual revenue is estimated to be \$4,43 billion.

The distributors for Herbalife participate either by buying products at discount for themselves and for their family or by selling products or by recruiting others who will consume or sell the products. These differentiation between distributors types should be clearly defined as discount buyers are not able to earn rewards or sell products. Distributor earns between 25-50% on their sales plus 5% royalty income override on monthly sales volume; same goes for the distributor's discounts that varies in the range of 25-50%.

By January of each year, sales leaders are required to requalify. In case they do not satisfy the requalification, they are removed from that rank for duration of 12 months. Herbalife used to consider retention of distributors as a key parameter and tracked it closely in financial reports.

In 2011 Herbalife was declared pyramid scheme by Belgian court to which it appealed in 2012 and gained reversal of the court's findings. As a result, there have been several regulations imposed to Herbalife, but it was not ordered to change the business model.

All presented MLM companies have their specifications but they all share clear and outlined main Network marketing aspects - pyramid structure, motivation and consequences.

### **5. Requirements for MLM business model to be successful**

Based on the above examination of the successful MLM companies we came up with the following main requirements for MLM business model to be successful:

1. There should be a limit number of levels as well as downline (pre-determined matrix), so the hypothetical extreme is never approached.
2. There should be a regular communication (train more effectively, transmit more information) between upline and downline distributors in order to increase productivity (will keep sales force turnover (attrition) ratio at low).
3. The independent distributors' performance should be monitored to ensure the sales; Possibly create target sales to be reached by each level of distributors.
4. The hierarchical commission system should be clearly defined.
5. There should be a quality product.
6. There should not be a fee to become a distributor.
7. The purchases of sales training materials should be completely voluntary.
8. There should be a buy back option for unsold inventory.
9. There should be a monitoring of an internal consumption proportion to external consumption (can have a mild target ratio).
10. The company should consider joining national (and international) Direct Selling association.

There are many types of network marketing program: single-tier, two-tier, multi-level tier. We believe that an effective and profitable MLM network fixes during the business design phase the number of level levels and the maximum number of distributors managed by a single person. This will help having a structured network model with an efficient flexibility in case of a need to change or fill a nod with a new recruit. This point is intensified by extensive research conducted regarding MLM systems that confirm the pattern that the only people at the top of the pyramids earn substantial money with others trailing far below with minimal or no earnings. That is why it is necessary to have pre-determined and possibly few levels and distributors managed by a single person.

It is easy to walk away from a business where you have not invested much or anything. For independent distributors the cost is zero and sign up is free. That is why the relationship between upline and downline distributors is important and upline should make it their duty to teach, motivate and cultivate their downline.

As a legal MLM strategy is based on revenue generation, the distributors should be focusing on sales. To make distributors active and sales profitable we believe it is a good option to set target threshold to be achieved per level of distributors per month or quarter. Upline distributors should use part of their time/effort to train and commit the downline, with a resulting lower selling effort. This leads to reducing the direct selling target, and increasing the indirect selling target, for the upline distributor.

Following the pre-determined matrix structure of network, the hierarchical reward system should be in compliance with it. The upline distributors should get a commission on their own sales revenue and on the sales revenue of their downline. The commission calculation method should be clear and with no hidden cost. The compensation plans have to be weighted correctly not to reward upline distributors for unjust reasons that are based solely on recruiting, as this will create extraordinary income discrepancies between upline and downline distributors.

It is very important to have a high-quality innovative product as it will be easier to actively sell it. Distributors should like what they are selling, as they need to be excited and enthusiastic about the product they propose to their clients.

Another requirement for MLM to be a legally acceptable business is not to have the so-called registration fee to join the network and become a distributor. Because the fee makes network marketing a pyramid scheme, as it profits from the increasing number of distributors even if distributors do not generate sales.

Following the same point above, training and product kits should not be charged as they should exclusively be dedicated to improving the efficiency and experience of the distributor. Also, this approach is useful to avoid reputational risk and, in case of no resulting sales, in a legal breach. With an alternative approach, definitely more constructive, different materials and trainings can be made available once a distributor achieves a specific sales target. This can increase their incentive to generate more sales.

In case a company requires distributors to buy inventory for reselling, it should also provide a guarantee of buying back the unsold stock. This also brings us back to the legitimacy of network marketing as the company should not exploit its distributors for not selling the products.

Internal consumption should not be a main source of revenue for MLM business. Even though there is no restriction or regulation applied to internal consumption metrics, this issue remains quarrelsome in many countries and US and Europe government regulators attempt to use it as a primary evidence of a pyramid scheme. It is widespread in network marketing to have a part of revenue derived from internal consumption, as companies give discounts to distributors and their families in order to retain employee loyalty. We consider it okay to maintain a healthy level of internal consumption by having a target threshold ratio established to monitor the proportion of internal vs external consumption. This would also help to moderate a concern about the ethicality of multilevel marketing in reference to selling the products and services to friends, family and relatives (internal consumption). An ethically strong approach is also a guarantor for the overall MLM ecosystem ensuring a better efficiency in maintaining motivation and consultants' performances.

There is industry self-regulation through codes of ethics that prohibits Multilevel Marketing companies to become members of Direct Selling Association in case they are perceived to be operating as pyramid schemes. Each country has its own Direct Selling Association and for a company to become a member, it has to comply with certain normative and ethical codes. The candidate for membership is subject to an observation period and when the correctness of the commercial practice is verified, the company is accepted in the

Association. Being a member of Direct Selling Association is a “guarantee” of operating legal MLM.

## **6. Conclusion**

MLM seems easy way to create business with low costs - with a minimal investment of time and money, but in fact it is not a network as simple to operate and manage as it might seem from the first glance. The confirmation of this is a historical high rate of “failure” of network marketing models.

- First, it is a business as easy to quit as it is to start, with not much needed in investment and consequently not much having to lose. In short it has low barriers to entry and to exit.

- Second, for distributors the opportunity is to make a quick buck and work part time. There is no commitment required, and the pace is decided by distributors themselves. If they do not have strong incentives, they are not going to perform well and eventually get discouraged and quit the network. That is why distributors retention rate in a multi-level marketing business is very low.

To succeed in this network scheme, one will need to treat this business model in the same way as any other business, with solid management and planning. The distributors have to be monitored and given strong incentives and encouragement to fulfill targets efficiently and do what it takes to make profit and increase the value of the company.

It is also easy for MLM to come close to be a pyramid scheme as it happened to Herbalife. Especially when the business is based on the recruitment side of the business rather than the selling of the products. Distributor should be supervised closely so that they do not get engaged in fraudulent and deceiving action to recruit people and MLM should follow proper plan to be a viable business model.