

Article

Multi-Level Marketing Businesses and Pyramid Schemes



Businesses that involve selling products to family and friends and recruiting other people to do the same are called multi-level marketing (MLM), network marketing, or direct marketing businesses. Some MLMs are illegal pyramid schemes. Before joining an MLM program, here are some things to know.

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What Are MLMs and How Do They Work?

MLM companies sell their products or services through person-to-person sales. That means you're selling directly to other people, maybe from your home, a customer's home, or online.

If you join an MLM program, the company may refer to you as an independent "distributor," "participant," or "contractor." Most MLMs say you can make money two ways:

- by selling the MLM's products yourself to "retail" customers who are not involved in the MLM
- by recruiting new distributors and earning commissions based on what they buy and their sales to retail customers

Your recruits, the people they recruit, and so on, become your sales network, or "downline." **If the MLM is not a pyramid scheme, it will pay you based on your sales to retail customers, without having to recruit new distributors.**

Most people who join legitimate MLMs make little or no money. Some of them lose money. In some cases, people believe they've joined a legitimate MLM, but it turns out to be an illegal pyramid scheme that steals everything they invest and leaves them deeply in debt.

What's a Pyramid Scheme and How Do You Spot One?

Pyramid schemes are scams. They can look remarkably like legitimate MLM business opportunities and often sell actual products, maybe even ones you've heard of. But if you become a distributor for a pyramid scheme, it can cost you and your recruits — often your family and friends — a lot of time and money that you won't get back.

The promoters of a pyramid scheme may try to recruit you with pitches about what you'll earn. They may say you can change your life — quit your job and even get rich — by selling the company's products. That's a lie. Your income would be based mostly on how many people you recruit, not how much product you sell. Pyramid schemes are set up to encourage everyone to keep recruiting people to keep a constant stream of new distributors — and their money — flowing into the business.

Often in a pyramid scheme, you'll be encouraged or even required to buy a certain amount of product at regular intervals, even if you already have more inventory than you can use or sell.

You may even have to buy products before you're eligible to be paid or get certain bonuses. You also may have to pay repeated fees for other items, like training sessions or expensive marketing materials. In addition, the company may say you can earn lavish rewards, like prizes, bonuses, exotic vacations, and luxury cars. However, it often turns out that you have to meet certain product purchase, recruitment, training, or other goals to qualify for the rewards, and only a handful of distributors ever qualify.

Eventually, most distributors find that no matter how hard they work, they can't sell enough inventory or recruit enough people to make money. They also can't keep up with required fees or the inventory purchases they need to make to qualify for rewards, and they can't earn enough money to cover their expenses. In the end, most people run out of money, have to quit, and lose everything they invested.

Here are some warning signs of a pyramid scheme:

- **Promoters make extravagant promises about your earning potential.** Stop. These promises are false.
- **Promoters emphasize recruiting new distributors for your sales network as the real way to make money.** Walk away. In a legitimate MLM program, you should be able to make money just by selling the product.
- **Promoters play on your emotions or use high-pressure sales tactics, maybe saying you'll lose the opportunity if you don't act now and discouraging you from taking time to study the company.** Leave by the nearest exit. Any company that tries to pressure you to join is one to avoid.
- **Distributors buy more products than they want to use or can resell, just to stay active in the company or to qualify for bonuses or other rewards.** If you see this happening, keep your money.

Is an MLM Right for You?

If you're considering joining an MLM, know that some MLMs — even ones that aren't pyramid schemes — may not be a wise investment. Other MLMs may not be a good fit for your interests and lifestyle. Here are some ways to help protect yourself against a bad MLM experience.

Ask yourself these questions

- **Do you want to be a salesperson?** If you join an MLM, you'll be a salesperson. Your job will be to sell the company's product and, in many cases, to convince other people to join, invest, and sell. If you don't like selling, or if you're uncomfortable asking people you know to put their time and money into a business venture, joining an MLM is a bad idea.
- **Do you have a solid sales plan?** Consider whether you have friends and family who will buy this product from you over and over again. Think about how you would find and keep other regular customers. Can people buy something like this product elsewhere, maybe for less?
- **What are your income goals?** You might think that, with your willingness to work hard, you can earn substantial income through the MLM. In fact, most people who join MLMs and work hard make little or no money, and some of them lose money.
- **Can you afford to risk the money and time?** Every business venture has risks. MLMs are no different. Even if the start-up costs seem low, additional expenses can add up quickly. Expenses can include training and travel costs, website fees, promotional materials, costs to host parties, and costs to buy products. If you need to borrow money or use your credit card to finance your expenses, you may face hefty interest charges too. Also, consider the time demands of the business, like going to training, recruiting new distributors, managing paperwork, recording inventory, and shipping products.

Do your homework

- **Research the company.** Search online for the name of the company and words like "review," "scam," or "complaint." You may also want to look for articles about the company in newspapers, magazines, or online. Does the company have a good reputation for customer satisfaction? Check with your [state attorney general](#) for complaints. A lack of complaints doesn't guarantee that a company is legitimate, but complaints can alert you to possible problems.
- **Research what distributors are saying.** Individual distributors often post their own training videos online to promote the MLM. Search for these materials. Be suspicious if the trainings make earnings claims, tell you that the fastest way to make money is to "recruit, recruit, recruit," or suggest that all you need to do to build a downline is "find two people who find two people." Claims like these are hallmarks of a pyramid scheme.
- **Consider the products.** MLM companies may sell quality items at competitive prices. But some offer goods that are overpriced, have questionable benefits, or are downright unsafe to use. For example, be very skeptical about health products advertised as having "miracle" ingredients or guaranteed results. Those claims are generally false or at least unproven and, at worst, the products could be dangerous.
- **Understand the costs.** Many MLMs make you buy training or marketing materials, or pay for seminars on building your business. You may need to book travel and pay for hotels and meals. Make sure you know what you must pay for, and how much it will cost over time. If the company says some of these things — like periodic product purchases or training — are optional, find out if you'll become ineligible for bonuses or rewards if you opt out of them.
- **Ask about refunds.** In many MLMs, before you can start selling the products, you have to buy them from the company. So get the company's refund policy in writing. Make sure it includes information about returning any unused products, including restrictions and penalties. Consider whether you'll get a full refund or only a partial one — and how long it may take.
- **Read the paperwork and have a friend or advisor review it.** Read the company's sales literature, business plan, disclosure documents, and any contracts or agreements you'll need to sign. Ask an accountant, a lawyer, or someone else you trust — and who is **not** affiliated with the company — to help you review the MLM's materials. Ask them to look at your possible earnings and whether the company can back up its claims about how much money you can make. Ask for their honest opinion about whether they think the MLM is legitimate and a good fit for you.

Talk with current and past distributors about their experience in the MLM

Ask tough questions and dig for details. Don't consider it nosy or intrusive. You're thinking about starting a small business. A good businessperson needs those answers. Here are some questions to ask:

- How long have you been in the MLM?
- How much money did you make last year, after expenses?
- What were your expenses last year?
- Have you borrowed money or used your credit card to fund your business? How much did you borrow? How much do you owe?
- Do you need to have recruits to make money?
- How many people have you recruited? How many did you recruit last year?
- How many of your recruits have left the business?
- What percentage of the money you made came from selling the product to customers outside the MLM?
- What percentage of the money you made — income and bonuses less your expenses — came from recruiting other distributors and selling them inventory or other items to get started?
- How much time do you spend on the business?
- How much inventory did you buy from the MLM last year? Did you sell all of your inventory?

Remember, you're on a mission to check out a potential business deal that will require your time and money. The information you learn can help you decide whether it's really a deal, a dud, or straight up illegal.

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