ctc

.ck
.rick Mgmt. Inc.
North Carolina,USA
.or, *False Profits:*
ng Financial and Spiritual
.iverance in Multi-Level
Marketing and Pyramid Schemes

Susanna Perkins
Pres., BackStreet Publishing
Orlando, Florida, USA
Publisher, *Behind the Smoke and Mirrors: Amway Motivation Organizations*

Eric Scheibeler
Pres., Verity Consulting Group LLC
Montoursville, Pennsylvania, USA
Author, *Merchants of Deception*

Advisors:

Brock Akers
Attorney, Phillips & Akers
Houston, Texas, USA

Stephen Barrett, M.D.
Pres., MLMWatch.com and QuackWatch.com
Allentown, Pennsylvania, USA

Douglas Brooks
Attorney, Gilman and Pastor
Boston, Massachusetts, USA

Bruce Craig
Asst. Attorney General (Retired)
State of Wisconsin
Madison, Wisconsin, USA

Gary Langan Goodenow
Attorney
Author, *e-scamDOT.con: An Insider's Look at Securities Fraud, the Internet and the SEC*
Miami, Florida

Naotaka Katoh
Professor of Law
Kokushikan University
Tokyo, JAPAN

J. B. Meade
Attorney, Gordon, Thomas, Honeywell, Malanca,Peterson & Daheim, PLLC
Tacoma, Washington, USA

Joyce K. Reynolds
Pres., PHOENIXjkr
Fort Lauderdale, Florida, USA
Co-Author, *False Profits*

Jon M. Taylor, Ph.D
Pres., Consumer Awareness Institute
Salt Lake City, Utah, USA
Author, *The Network Marketing Game*

International Association to Expose, Study and Prevent Pyramid Schemes

1800 Camden Rd.
Ste. 107 #101
Charlotte, NC 28203
USA

Tel. (704)334-2047
Fax (704)334-0220
info@PyramidSchemeAlert.org
www.PyramidSchemeAlert.org

FEDERAL TRADE COMMISSION
RECEIVED DOCUMENTS
JUL 14 2006
SECRETARY

July 6, 2006

Att: Steven Toporoff **FTC Business Opportunity Rule, R511993**
Federal Trade Commission/Office of the Secretary,
Room H–135 (Annex W),
600 Pennsylvania Avenue, NW.,
Washington, DC 20580.

Please accept the official comment of Pyramid Scheme Alert (PSA), a non-profit consumer organization. It is enclosed. Additionally, PSA requests to be invited to testify and offer its research at Hearings scheduled on the Business Opportunity Rule.

Pyramid Scheme Alert (PSA) is the largest and most active non-profit consumer organization with the mission of analyzing, exposing and educating consumers about pyramid marketing schemes. Formed in November 2000, PSA assists thousands of consumers each year with email or direct phone assistance. Its website, http://www.pyramidschemealert.org, offers tools, research, and news for distinguishing pyramid schemes from direct selling. PSA directors and advisors have served as expert witnesses for the US Dept. of Justice and numerous state Attorney General offices in pyramid scheme prosecutions.

The "pyramid marketing schemes" referenced in the FTC proposed rule harm more people than any other type of "business opportunity" fraud. They employ mass meetings to entrap consumers. They falsely promise income to all that join based on the trick of "geometric expansion" of an endless chain. They claim to offer viable income opportunities while inflicting losses upon 99% of all participants each year.

"Pyramid marketing schemes" disguise themselves as "direct selling". All such scams operate as "multi-level marketing (MLM)". In a separate mailing, I have provided a statistical report documenting that more than 99% of all participants in major multi-level marketing schemes never earn a profit.

Pyramid Scheme Alert proposes three components of the FTC rule requiring disclosures from multi-level marketing "business opportunity" schemes.

1. Disclosure of Retail-based Income Averages:
The distinguishing feature of the MLM pyramid scam is the lack of profitable retail sales among most participants. Retailing is the dividing line between bogus, deceptive scams and legitimate direct selling. This standard has been applied consistently by the FTC in more than a dozen prosecutions, written into state laws, and repeatedly upheld by federal courts.
Pyramid Scheme Alert, therefore, proposes that the FTC adopt rules that require the disclosure of average retail-based income for participants in each level of a multi-level marketing (MLM) scheme. This data can be gathered by survey or direct reporting by participants. The FTC must insure that the data is verifiable.

2. **Require that all multi-level marketing schemes make "income claim" disclosures:**
An "income claim" is inherent in all multi-level marketing companies, which, by definition, are "income opportunities." Therefore, no option should be allowed for any multi-level marketing company to check the box indicating it makes "no earnings claim".

3. Disclose total number of participants and average costs to participate:
A common deception of pyramid marketing schemes is to provide recruits with a mean average of "income" for each level in the scheme's hierarchy or an overall mean average of "income" only for "active" participants.

These mean averages are misleading and deceptive. They skew the average upward by excluding large numbers of participants that drop out during the year. This can be as many as 60% of the actual total.
An even more harmful practice is the omission of business costs - money paid out by participants to the income-opportunity-scheme - thus hiding large-scale losses by nearly all participants
"Money paid out" includes incentivized purchases and associated business costs that are presented as mandatory or necessary to success, such as motivation seminar registrations, audio and videotapes, etc. When such costs are factored, 99% of participants lose money.

Thank you for the opportunity to offer comment. We are prepared to answer questions and to offer additional information. We formally request a hearing where the full facts about the economic impact of pyramid marketing schemes can be presented.

Sincerely,

Robert L. FitzPatrick, President
PYRAMID SCHEME ALERT
RFitzPatrick@PyramidSchemeAlert.org

FITZPATRICK

July 6, 2006

Att: Steven Toporoff **FTC Business Opportunity Rule, R511993**
Federal Trade Commission/Office of the Secretary,
Room H–135 (Annex W),
600 Pennsylvania Avenue, NW.,
Washington, DC 20580.

Please find enclosed a documented statistical analysis of the "income opportunity" being marketed by multi-level marketing companies, including the largest and oldest, Amway/Quixtar. As the report author, I submit it in support of comments regarding FTC Business Opportunity Rule, R511993. The report is online at http://www.falseprofits.com/MythofMLMIncome.doc.pdf.

Additionally, I request that a Hearing be held to consider the systematic, pervasive deception employed in the multi-level marketing business, in which the conditions laid down for legitimacy in the 1979 FTC Amway case have been grossly and routinely violated. I request a Hearing so that factual data about unfair and deceptive trade practices can be reviewed and their widespread impact considered.

I am also author of the book, *False Profits*, which examines pyramid schemes and multi-level marketing. I have served as consultant and expert witness to the US Dept. of Justice and several state Attorney General offices. I have also delivered seminars to the staff of the FTC, the White Collar Crime Center and the National Association of Consumer Protection Investigators.

An "income opportunity" is, today, the main product in direct selling, not vitamins, legal insurance or skin lotions. And the key selling tools are "income claims." This report reveals that for nearly all investors, the MLM income opportunity is a myth and related income claims are deceptive.

This research documents that 99% of all sales representatives each year in the sample of companies analyzed earned less than $14 a week in commission income. This figure is BEFORE all business expenses, inventory purchases and taxes are deducted and therefore represents a significant financial loss for virtually all that join these schemes. Additionally, the report shows that on average no net income is earned on average by MLM distributors from door to door "retail" sales.

The devastating loss rates suffered by consumers offer compelling evidence that MLM businesses are operating as disguised pyramid marketing schemes as referenced in the Proposed Rule.

Contact:
Robert L. FitzPatrick
1522 Lilac Road
Charlotte, NC 28209 USA
Tel: (704) 334-2047,
Fax: (704) 334-0220
e-mail: RFitzPatrick@FalseProfits.com
http://www.falseprofits.com

Publications:

Therefore, FTC regulation is necessary now. The FTC must ensure that MLM schemes are retail-based, not endless chain scams. And, that they disclose enough financial information for a consumer to see that more than 99% of all investors never earn a profit. This requires disclosing actual RETAIL earnings and average COSTS in each level of the scheme.

The majority of direct selling companies of today that are represented by the Direct Selling Association utilize the multi-level marketing (MLM) model. This model operates outside the FTC Franchise Rule in a regulatory safe haven. Each year, more than 5 million Americans invest in these schemes, at least initially, based on the INCOME CLAIMS. We estimate collective losses each year in excess of $5 billion. The enormous number of investors and the collective losses make the multi-level marketing business the greatest source of "business opportunity" deception in the marketplace.

Though all products are available on the Internet, in big-box stores, by catalogue or in a multitude of retail outlets, a "business opportunity" can still be sold person-to-person where the factors of trust and relationship can be utilized to "get in the door" and strongly influence a consumer to invest.

MLM companies obscure their devastating failure rates and financial harm by disclosing the number only of "active" participants and limiting the income figures to a one-year or even shorter time frame, thus concealing the factor of the ongoing and mounting losses of new investors. Most MLMs do not reveal any data at all on actual average incomes. None offers a credible estimate of average RETAIL earnings. None offers any information to consumers about associated COSTS related to the "income claims."

Like any other force that contributes to general impoverishment, the losses that are inflicted by these schemes also damage credit worthiness, and break up marriages, end friendships and degrade communities.

Thank you for the opportunity to offer comment. I am prepared to answer questions and to offer additional information.

Sincerely,

Robert L. FitzPatrick, Author
False Profits, Seeking Financial and
Spiritual Deliverance in Pyramid Schemes
and Multi-Level Marketing

The Myth of "Income Opportunity" in Multi-Level Marketing

Including

Special Supplement

Income Analysis of Amway/Quixtar and its Secret "Tools" Business

by Robert L. FitzPatrick

©2005 PYRAMID SCHEME ALERT
1235-E East Blvd. #101
Charlotte, NC 28203
704-334-2047
RFitzPatrick@PyramidSchemeAlert.org
http://www.PyramidSchemeAlert.org

The Myth of "*Income Opportunity*" *in Multi-Level Marketing*

by Robert L. FitzPatrick

© 2005 Pyramid Scheme Alert

Introduction and Overview 3
The Disguise of Direct Selling 4
Part 1: How the MLM Income Myth Is Maintained
Confuse the Consumer 6
Claim "Legality" 7
Hide the Pyramid Math 9
Withhold Data 10
Obscure the Nature of the Business 11
Put on the Camouflage of "Product Sales" 12
Part 2: Exposing the Myth of MLM Rebate Income
MLM Data Sources 13
MLM Data Analysis: Breaking the MLM Secret Code
Data Disclosed by Companies 14
Method of Calculations 14
Revenue, not Profits 14
Retail Sales Costs and Income Excluded 15
Actual MLM Data
Estimated Nuskin Payouts 16
Estimated Nikken Payouts 17
Estimated Melaleuca Payouts 18
Estimated Arbonne Payouts 19
Estimated Reliv Payouts 20
Estimated Free Life Payouts 21
Estimated Cyberwize.com Payouts 22
Additional Data on Rebate Income Averages 23
Summary of Rebate Income Findings 24
Three Key Facts for Understanding MLM Rebate Payouts 25
Part 3: Exposing the Myth of MLM Retail Income
The Legal Significance of Retailing 26
The 70% Retail Benchmark 26
Retailing Realities 27
The Retail Income Myth Revealed 28
Data from 21 MLMs 28
Summary of Retail Income Findings 29
Bottom Line: No Rebate Profit, No Retail Profit 29
The Myth of Door-to-Door Selling 30
The Lure and the Hook 33
Blaming the Victims 34
Special Supplement: Amway/Quixtar Data and Analysis
The Secret Business 35
Lawsuits, Exposés, Consumer Protests, Tax Evasion, Defiance of Government Orders, Intense Political Influence-Peddling 36
Estimated Quixtar (Amway) Payouts - on a per 300,000 distributors basis 37
How the Quixtar Data Is Analyzed 38
Amway Data Disclosed on the Quixtar Website 39
Appendix
I. How to Recognize – and Avoid – a MLM Recruiting Scheme 40
Five Red Flags 40
Three More Tricks of Pyramid Perpetrators 41
II. How to Prevent MLMs from Operating as Pyramid Schemes 42
Audited Retail Sales 42
Full Disclosure 43

Special Consumer Report

The Myth of the MLM "Income Opportunity."

Introduction and Overview

The claim by multi-level marketing (MLM) companies of offering consumers a viable "part time income" or an "extraordinary income" greater than most other businesses or occupations is their hallmark attraction. It is also their greatest defense against persistent charges of pyramid scheme fraud, mind control and deceptive promotions. The question is whether MLM is a social and financial blight or a benefit to consumers. Legitimacy of this business ultimately hinges on the truthfulness or falsehood of its income claims. It is a question that affects the fate and fortune of more than five million new recruits in North America every year and countless more in other countries.

This report reveals that 99% of all sales representatives *each year* in the sample of companies analyzed earned less than $14 a week in rebate income. This figure is before all business expenses, inventory purchases and taxes are deducted. The figure therefore represents a *significant financial loss* for virtually all that join these schemes. Additionally, the report shows that on average *no net income is earned on average by MLM distributors from door to door "retail" sales.*

MLM companies seek to obscure their devastating failure rates by disclosing the number only of "active" participants and limiting the income figures to a one-year or even shorter time frame, thus concealing the factor of the *ongoing and mounting losses of new investors. Most MLMs do not reveal any data at all on actual average incomes.*

If *all* the participants over a five-year period are included in the calculations, the failure rate rises even further. Less than one in one-thousand will be shown to have gained any profit at all. The so-called successes in MLM are in the same small group positioned, year after year, at the top of the recruitment organization.

The business model and business practices of most multi-level marketing companies directly cause the financial losses suffered by millions of consumers, not normal competitive factors or the levels of efforts or talents of the participants.

The collective losses represent an enormous transfer of money from several million people in the US *each year* to a handful of owners and recruiters. Like any other force that contributes to general impoverishment, this income transfer damages credit worthiness, breaks up marriages, ends friendships and degrades communities.

Of the two categories of the MLM income opportunity, *rebate income* and *retail sales income*, the most publicized are the rebates, commissions and bonuses paid out on the *purchases* by "downline" recruits. This is the source that the companies claim has "unlimited potential" based on the opportunity to derive payments from an "endless" chain of recruits. MLM allows all distributors to recruit others and qualified distributors to receive rebates on the purchases made by multiple levels of recruits that recruit more recruits.

This report analyzes data from eight representative MLM companies. Seven of the companies that are analyzed are major and very well-known MLM companies and are members of the Direct Selling Association. One is newer and growing and not a DSA Member. Charts are provided showing the actual commission payouts on a per-10,000-sales-representatives basis for seven companies. The data show not only that virtually no recruits earn rebate profits but also

 © 2005 Pyramid Scheme Alert

that the MLM payout schemes transfer the lost investments of the great majority of participants to a tiny number of organizers at the top of the recruitment chains.

A special supplement is provided on the rebate data from the oldest and largest of all multi-level marketing companies, Amway/Quixtar, which is also a member of the Direct Selling Association. The analysis for Amway/Quixtar is presented on a per-300,000-distributor basis. It reveals the same pattern of 99+% annual loss rate and a concentration of payments to a tiny number of promoters at the top.

Amway/Quixtar figures must be considered separately because an additional business is run by its top distributors that provides more of their income than payments from the Amway/Quixtar business itself. The operation of this second scheme inside the sales organization of Amway/Quixtar – known as the "tools" business and involving the sales by the kingpin distributors of books, tapes and seminar registrations to new recruits – affects the Amway/Quixtar pay plan and its recruitment tactics.

Operated without the knowledge of new recruits, this "secret" income source has been revealed in lawsuits and websites for many years. In May 2004, the highly respected national news program *NBC Dateline* brought hidden cameras into Amway/Quixtar recruitment meetings and exposed the scheme. As the report showed, the Amway "kingpins" make most of their money by deceptively recruiting people, not from selling Amway products.

The Disguise of Direct Selling

The second element of the MLM "income opportunity" is the claim of profit from retail sales by MLM sales representatives to consumers. The retail sales opportunity is the basis for the industry's claim that it is a form of "direct selling." Additionally, the retail sales potential is held up as a defense against pyramid scheme charges since the payments to the upline are based on the product purchases of new recruits, not chiefly on entry or membership fees.

This report exposes the myth and refutes the claim of MLM as a "direct selling" business that is based on retail sales. *Due to factors outlined in the report, the MLM sales force seldom carries out retail selling*. A statistical review of twenty-one (21) MLM companies representing 5 million sales people and "projected" retail sales of $10 billion reveals that even if retail sales are assumed to be occurring, *the average MLM sales person is not earning a net profit from retail sales.*

MLM companies have numerous ways to obscure the fact that most are *non-retailing* operations disguised as "direct selling" companies:

- Some MLM companies calculate total *purchases* of sales representatives and then *project* an average "retail profit" without verifying if any products are actually retailed or not, what price they were resold for or whom they were sold to. While retailing to consumers is publicized and claimed, internally the companies' pay plans are based entirely upon *wholesaling* only to the distributor recruits. Whether any retail sales ever occur or not, the upline recruiters are paid rebates only on the *downline's wholesale purchases*, never on retail pricing charged to the end-user.
- Some companies claim they "require" retailing by their distributors, but no systematic method is used to audit retailing activity. That a company would have to "require" selling by its salespeople reveals the inherent flaw in the MLM model and its tendency toward operating as a pyramid recruitment scheme.

 © 2005 Pyramid Scheme Alert

- Some MLM companies actually advertise their total sales volume based on unfounded retail projections, even reporting these mythical numbers to the Securities and Exchange Commission and promoting them to shareholders.

The findings in this report raise the question of how a business in which almost none of its sales representatives earns a profit and almost none has a sustainable retail customer base could be called "direct selling"? Indeed, how could such an enterprise be considered a legitimate "business" at all?

 © 2005 Pyramid Scheme Alert

Part 1: How the MLM Income Myth Is Maintained

Confuse the Consumer

Prior to this report, consumers have had little or no useful data on MLM income claims. Consumers are, however, subjected to barrages of personal "testimonials" and "success stories."

Multi-level marketing employs a seemingly indecipherable language to explain its trademark "compensation plans" and business model that permit unlimited authorization of sales representatives and that pay rebates based on purchases by new recruits who are recruited by the earlier recruits in an endless chain.

- ▲ They refer to the model as *consumer direct marketing, one-to-one marketing, personal franchising, network marketing* and many other colorful but ultimately misleading terms.
- ▲ Some MLMs describe their pay plans as unique or much more beneficial than others in the industry. They use specialized terms *as stair-step breakaway, legs, binary* and *trinary, PV* and *BV*, yet most of these pay schemes are essentially identical and yield the same ruinous financial outcome to the average participant.
- ▲ Circles and diagrams are drawn at recruitment meetings and a complex organizational hierarchy is presented, including as many as 12 levels with names such as *Regent, Platinum, Diamond* and *Blue Diamond.*
- ▲ There are leadership bonuses, breakaway bonuses, production bonuses, multiple commission levels, and numerous types of "rebates."
- ▲ Often a "suggested retail price" is applied to goods that are never retailed.
- ▲ Rebates, which are only discounts on the investor's own purchases, are classified as "income."
- ▲ "Distributor markup" is sometimes used interchangeably with "gross profit" as if they are the same.[1]
- ▲ Qualifications to earn payments or rebates depend on a complex factoring of "personal group" purchase volumes, the rank of the sales representative and the size, configuration and purchase volumes of the "downline."

Other methods of confusing the consumer include:

- Information on income put forth by some MLM companies or the MLM industry at large often mixes income data from MLM with statistics from traditional direct selling companies such as Avon and Tupperware.[2]

---

[1] Gross profit is a percentage of profit calculated on the actual retail sales price. An item purchased by the reseller at the wholesale price of $100 and sold for retail price of $200 has a 50% gross profit. The "net" profit will be much less than gross profit. It is reduced by all costs involved in sales and marketing and other overhead expenses. "Distributor markup" is the percentage of the suggested retail price based on the wholesale price. It is just a theoretical figure since it is not based on the actual selling price and does not factor any of the sales costs. In the example just cited, the "distributor markup" is 100%. Some MLMs will refer to higher distributor mark up figure as the "profit" and omit sales costs altogether.

[2] The Direct Selling Association, the official trade organization of the multi-level marketing industry, throws all kinds of direct selling companies - retail-based with strong brand names along with hundreds of little known MLMs

 © 2005 Pyramid Scheme Alert

- Nearly all data that is presented by the MLM industry omit estimates or averages of normal business costs such as auto, telephone, travel, training or postage and shipping to operate an MLM business. In this way "gross income" is confused with "net profit."
- Inventory purchases are also ignored as business costs and are mingled or confused with purchases for "personal use or consumption."
- Many MLM companies offer "average incomes" that are actually *mean averages* that meld the huge incomes of those at the top with thousands of others that make nothing at all. This leaves the impression that the "average" MLM participant actually earns a "profit", when almost no one does.[3]
- Some use data only on "active" participants and exclude all those that had earned nothing and quit – the majority in some companies – thereby reducing the number of sales people divided into the total payouts and increasing the "average income."
- A similar misleading device is to count only the "active" distributors in a one-year time frame. This ploy conceals that the top level distributors who profit year after year are the same people whose numbers do not increase, while the new recruits that lose year after year are a revolving group *whose numbers mount each year*. The actual number of "losers" multiplies year by year. The number of "winners" remains the same and does not grow. If a longer time frame were used, a true ratio of gainers to losers would emerge that would shock and discourage any new recruit.
- Figures are almost never revealed on how many consumers join and quit the program each year, thus concealing the "revolving door" nature of the scheme and the fact that no stable customer base exists.
- And, for most companies, percentages of rebate payments that are paid to each level are not disclosed nor is the percentage of money earned on offshore sales. When the payout per level is disclosed in a manner that is understandable, the gross concentration of payments to the top organizers is revealed along with the massive losses to all others.

In short, MLM solicitors do not disclose the basic financial information needed to make an intelligent investment decision. Many people therefore join on the basis of hope or the personal recommendation of someone else who has also joined on the basis of hope or on the blind faith in the claims made by the company about the "income opportunity."

Claim "Legality"

Another element of maintaining the MLM myth of legitimacy and a viable income opportunity is based on the claim that, regardless how it operates, MLM is still "legal." As a legal enterprise, "success" in the business is then said to be the result of "hard work" and "following the system" recommended by the organizers – as would occur in legal businesses. Failure rates and financial losses among those recruited into MLM – regardless of their scale – are then treated as an outcome of normal business risks and markets forces or the fault of the individuals who lose. The

- into its figures. It offers color charts and graphs, but the figures include so many different types of companies and sales people it is of no practical use to a consumer.

[3] In the case of Nuskin figures, for example, the mean average payment to all the "active" distributors was $1,465, or $122 a month. However, if the income of the 2% at the top of the pyramid is taken out, the mean average of the 98% who are at the bottom of the chain was only $310 or $6 a week (indicating a massive loss rate). A closer analysis reveals that the bottom 86% received no rebate payments at all.

 © 2005 Pyramid Scheme Alert

claim of technical legality is used to affirm financial legitimacy, to conceal a flawed structure that *requires* the vast majority to lose, and to justify systematic deception.

Until about 25 years ago in the United States, endless chain sales schemes were routinely viewed as illegal pyramid schemes or "unfair and deceptive trade practices." *Any* sales company employing an endless chain to sell or market its products was seen as fraudulent due to the certainty of financial losses they perpetrate on the vast majority of participants and the necessary use of deception to lure participants. This report, however, does not directly address the question of whether the MLM endless chain system is legal or not. Since 2000, the Federal Trade Commission has avoided prosecuting or overseeing the MLM industry to any significant extent, making the question of legality moot in terms of consumer protection. MLMs today operate largely without oversight. Consumers are on their own to know whether they are being defrauded or not.

Whether or not an endless recruitment chain is declared legal and whether or not the FTC ever prosecutes any particular MLM will not change the disastrous financial results such schemes inflict upon consumers. Endless chains – without the majority of people in the chain earning the majority of their income from retail selling – will *always* produce a massive loss rate for participants.

In the rare cases where the FTC has prosecuted MLM companies, it based its cases on the key factor of whether the majority of the sales of the MLM were made to consumers outside the chain, that is, sales made on a retail basis to people who are not also MLM sales representatives and occupy positions on the chain.[4] This factor was used to determine whether the MLM is a "direct selling" company or a pyramid recruitment scheme. The reasoning for treating "non-retail" schemes as illegal pyramid recruitment schemes was based on federal court interpretations and rulings that cited the defining factor of retail revenue versus revenue gained primarily from the sales representatives themselves.[5]

---

[4] "In distinguishing between a pyramid scheme and a legitimate business, the critical issue is whether rewards paid in connection with recruitment are tied to, or are derived from, the sales of goods and services to the general public (i.e. retail sales)"-- *Declaration of Peter J. VanderNat, Ph.D, FTC Economist and Pyramid Expert in FTC vs. Equinox International Corp., 1999*

"Pyramid schemes now come in so many forms that they may be difficult to recognize immediately. However, they all share one overriding characteristic. They promise consumers or investors large profits based primarily on recruiting others to join their program, not based on profits from any real investment or real sale of goods to the public. Some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure... A lack of retail sales is also a red flag that a pyramid exists. Many pyramid schemes will claim that their product is selling like hot cakes. However, on closer examination, the sales occur only between people inside the pyramid structure or to new recruits joining the structure, not to consumers out in the general public." -- *Prepared Statement of Debra A. Valentine, General Counsel for the U.S. Federal Trade Commission on "Pyramid Schemes" Presented at the International Monetary Fund's Seminar on Current Legal Issues Affecting Central Banks, Washington, D.C., May 13, 1998*

[5] One of the largest MLMs that was prosecuted by the FTC is Equinox International, a member of the Direct Selling Association (DSA) with over 100,000 distributors in all 50 states and in Canada. Equinox sold branded, quality, legitimate products. It was ranked #1 in INC Magazine's prestigious list of "500 Fastest Growing Privately Held Companies." The FTC case was based on the fact that less than 20% of all its products were ever resold to actual consumers. More than 80% were sold only to Equinox's own sales representatives. The sales representatives sought to recoup their investments by getting rebates based on the purchases of new sales representatives they recruited.

 © 2005 Pyramid Scheme Alert

Hide the Pyramid Math

Beyond legal interpretations, the FTC's justification for prosecuting the non-retailing companies also rests on simple math that any consumer can understand. The math referred to by the FTC is important to the data and conclusions of this *Pyramid Scheme Alert* report on the MLM "income opportunity." Obscuring this math is another important element of maintaining the myth of MLM income.

The math factor can be illustrated in a simple 6-level chain in which each person recruits just 5 people. At least three levels of recruits (5 + 25 +125 = 155) are needed for each participant to begin to achieve a profit based on override commissions from the purchases of the "downline."

Illustration:

Top Level - 1
Level #2. - 5
Level #3. - 25
Level #4. - 125
Level #5. - 625
Level #6. - 3,125
3,906 participants total

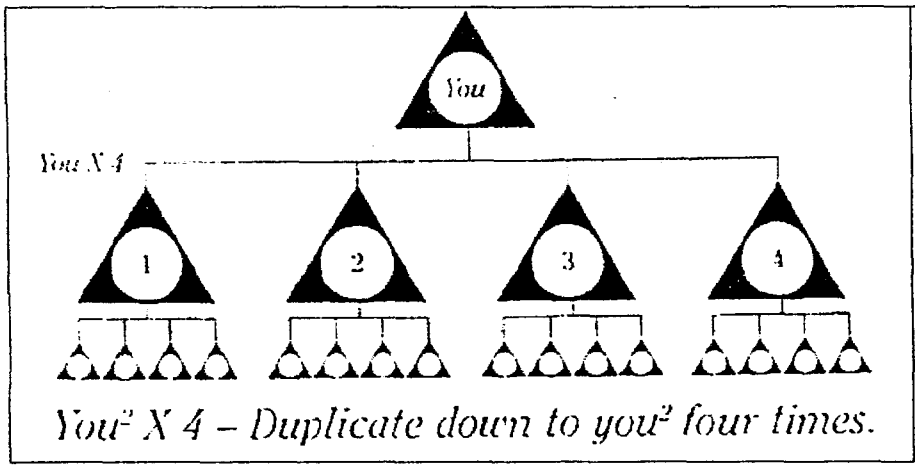
Since only those with three levels below them are profitable, only the Top Level person and the individuals in levels #2 and #3 qualify. Each of the people in next three levels below does not have enough "downline" to generate a profit. (Those in Level #4 each only have 25 in their downlines. Those in Level #5 each have only 5 people, and those in Level #6 at the bottom have none. This means that only 31 out of 3,906, or less than one percentage in the six-level chain, have as many as three levels below them and are profitable. More than 99% are unprofitable based on their position.

This basic formula holds true no matter how much further the chain extends. Approximately 99% are at the bottom of the chain where profit is not possible. For example, if the scheme recruited one more level, Level #7, another 15,625 participants would join. The total would now be 19,531. The number in profitable positions, Top, and the individuals in Levels #2, #3, and #4, would grow to 156, and this number would still equate to less than 1% of 15,625-person organization.

The big numbers, which are cited by the scheme's promoter as providing "extraordinary income potential," are based on overrides from the deepest level of the "downline." Only a tiny few can ever recruit to this level. This is mathematically predetermined from the start by the MLM structure and pay plan. The pay plan itself dooms the vast majority to financial losses, not factors of "hard work" or "following the plan."

The trick of the scheme is to cover up this reality and to convince each and every enrollee that he/she can succeed by building this large and deep downline. Recruits are told that the program is a formula for wealth that "anyone can do." A classic method of playing this trick on the recruits is the use of diagrams to illustrate the "explosive potential" of "exponential" recruiting or "duplication." Nikken, one of the four companies whose income data is analyzed in this report, uses the following typical chart in its recruitment literature.

 © 2005 Pyramid Scheme Alert



The illustration portrays the power of "duplication." One person who recruits just four others can quickly gain a downline of 16 more sales representatives and many more as the process continues. What the chart does not show is that if the plan continued just 16 levels in the manner that Nikken depicts, the bottom level would need over 4 billion new recruits!

Theoretically, the bottom levels could recoup their money by finding new distributors to join under them, but that would continue to work only if the scheme could go on *forever* and there were an *infinite* number of people.

In summary, if the income opportunity depends ultimately on purchases by sales representatives that are recruited "downline" rather than on the retail sales by those sales representatives, the upline-downline structure will always require that the vast majority of sales representative be the bottom of the "downline." *Their losses serve as the ultimate source of profit to a very small number in the "upline."* The sales representatives occupying the lower level positions on the chain cannot earn a profit until they, in turn, recruit a much larger group of new recruits below them. The proportion of a very small number of sales representatives at the top, where income is possible, to the very large number at the bottom, where income is not possible, *will remain the same as long as the business continues.*

Whether such a scheme is deemed legal of not, the losses will occur just the same. Personal testimonies from those at the top, high motivation of participants, inspirational speakers at sales rallies, strict adherence to the "system" advised by the leaders, and extraordinary time and effort of new recruits cannot change the laws of mathematics and the MLM business model, which dictate a massive "failure" rate and a miniscule "success" rate.

Withhold Data

Gross deception is necessarily employed in order to lure large numbers of consumers into programs where they will suffer their pre-determined loss. If the truth were known and understood, few consumers would willingly join.

Other enterprises such as gambling casinos and lotteries also are based on a large number of consumers losing as a means of rewarding a few "winners." These enterprises are strictly regulated and the odds for "success" are fully disclosed. The inevitability of losses is clearly stated and well understood. The expenditure of money is treated as entertainment. No one would seriously characterize gambling or playing the lotteries as viable "income opportunities" or career choices for consumers.

Pyramid Scheme Alert's research reveals that the "odds for success" for consumers investing in many multi-level marketing companies *each year* are actually worse than for some forms of legal gambling. *When all the participants over a multi-year period are included in the calculations – all of whom sought a winning position – the failure rate rises to 99.9% or even worse. To attain*

 © 2005 Pyramid Scheme Alert

a position of high income – which the promoters lure investors with – the "odds" are too low to be graphically illustrated.

Moreover, unlike lotteries and casinos where success is based on random rolls of the dice or picking of numbers and each participant has an equal chance, success in MLM is based on *positioning and timing*. Only the top positions – usually those who joined early or organized the scheme – can gain a profit, and only a tiny number can ever be at the top. The winners already occupy the *positions* that are *guaranteed* of success each time that a new participant makes an investment. The losers – those who are the latest to join the scheme – *have virtually no chance* to replace those already positioned at the top.

Yet, even using the MLM industry's own restrictive method of accounting, analysis of available data reveals that more than 99% of all "active" consumers who invest money and time in multi-level marketing never earn a profit. Some lose hundreds, others thousands of dollars. And still others are drawn into financial ruin gripped by the myth, which the MLM industry has carefully cultivated, that the multi-level marketing business offers the best opportunity for earning a living and becoming wealthy.

The massive consumer losses are the direct result of the MLM industry's concerted efforts to withhold or obscure vital financial and historical income data from the investors who buy into the business as sales representatives. This withholding of data is compounded by large-scale dis-information campaigns in which the business is characterized as a lucrative income opportunity and a sustainable income source for the average participant. Most of the MLM companies hold huge rallies where attendees are aroused to a frenzy of hope and expectation about the wealth and freedom they are told they will achieve in the business.[6]

Obscure the Nature of the Business

Multi-level marketing is not the same as direct selling any more than it is franchising. Avon and Tupperware are direct selling businesses, but not multi-level marketing.

Multi-level marketing is a specialized business model. It differs significantly from traditional direct selling in its unique and characteristic policy of authorizing *every* active sales representative to recruit others and to earn override commissions from the purchases of generations of recruits in a multi-tiered chain. This use of the "endless chain" of recruiting is the main point of controversy. It is the characteristic that invites the financial abuse and deception. The override commissions paid directly by the company to recruiters are the primary source for the promised incomes in MLM, while retail sales profits are the primary source of income in traditional direct selling.[7]

---

[6] In its May 7, 2004 report *NBC Dateline* brought hidden cameras into a 2003 Amway/Quixtar rally of 10,000 recruits in Greenville, SC where attendees were urged to quit their jobs and become Amway sales representatives. They were led in a thunderous chant, "Freedom! Freedom! Flush that stinking job!"

[7] The FTC has never issued a rule that defines or regulates multi-level marketing. Instead, the FTC offers consumers a blanket warning against the most highly promoted and unique characteristic of MLM - the ability to earn money on overrides from the "downline". On its website, the FTC has warned, "Be cautious of plans that claim you will make money through continued growth of your "downline" - the commissions on sales made by new distributors you recruit - rather than through sales of products you make yourself." Currently, the FTC advises consumers to "Avoid any plan that includes commissions for recruiting additional distributors. It may be an illegal pyramid." Note: All MLMs increase commissions based on the levels of recruitment achieved. In fact, the only way to earn the high incomes that are advertised is from recruiting more distributors.

 © 2005 Pyramid Scheme Alert

The MLM management chain is not the same as management structures used by traditional sales companies. Traditional direct selling companies can organize entire countries with four levels of managers overseeing a direct sales force that retails directly to the consuming public or to business end-users. In MLM companies, the number of levels expands "infinitely" as upper levels are awarded bonuses on the purchase volumes of extended generations of 12-level chains that have "broken away" when they reach purchase-volume thresholds. In this way, many MLMs function as "endless" chains.

The multiple levels are each paid some commission on each purchase made by new recruits. Usually between 40-60% of the price paid by the new recruit is redistributed to the recruiters above the latest entry level. In many cases, the total amount of the wholesale price that is paid to the "upline" exceeds the maximum gross profit the new recruit could earn if he/she were to retail the product at full price.

Put on the Camouflage of "Product Sales"

Though virtually none of the "sales representatives" ever earns a profit or has any "customers," a pyramid scheme can be made to appear as a "sales company." This is because each new recruit makes a purchase of products and the commissions are all based on the purchases of products by other recruits. There may be virtually no end-users, just a long chain of "distributors." The few sales representatives that do earn a profit do so only from a continuous influx of newly recruited investors (other sales representatives/distributors). If the recruitment program ends, their income ceases.

Though the recruitment-based scheme is camouflaged to appear as a "sales" company, the classic elements of the pyramid scheme fraud are all present:

1. Multiple levels of investors to bring in more recruits;
2. Payments to gain and maintain a position on the chain;
3. Recruitment required to move up the chain where rewards are paid;
4. Early investors are paid directly from the newest recruits' investments;
5. A structure that places the vast majority permanently at the bottom where no income is possible;
6. Each succeeding level in the recruitment-based scheme must be larger than the one above, and the numbers of total participants must grow successively, e.g. five sales representatives recruit 25 who must recruit 125 who recruit 625, etc. until saturation.

Such a scheme can never stop recruiting. It can never stabilize since it has no true customer base. For as long as the scheme operates and expands, the opportunity for recruiting declines, thereby further reducing the opportunity for income. Profit in such a scheme is not true profit but only a transfer of money from the latest recruits to the earlier ones.

Yet, the laundering of money through product purchases can camouflage the entire operation as a "sales company" based on "products" – not fees. The product sales in a recruitment scheme are induced by the false promises of income tied to ongoing inventory purchases. No purchase may be required to join the scheme, but monthly purchases are required to "qualify" for the "unlimited income" opportunity.

 © 2005 Pyramid Scheme Alert

Part 2: Exposing the Myth of MLM Rebate Income

Data Sources

Pyramid Scheme Alert compiled an analysis of the actual average incomes of a sample of 10,000 sales representatives for Nuskin, Nikken, Melaleuca, Reliv, Arbonne, Free Life International and Cyberwize.com. These seven multi-level marketing companies, six of which are large, well-known members of the Direct Selling Association (DSA) and the seventh a newer and fast-growing MLM, are regarded in the multi-level marketing business as representative examples of that industry. They are representative in product type, pay plan, business structure, and marketing claims of the majority of multi-level marketing companies. The companies were selected based on the data available but also on the representative nature of these companies.

The figures used in the analysis are from public documents of the companies themselves and they only include payments made by the companies to the sales representatives in rebates and commissions. The percentages and actual dollar figures have been extrapolated to a "per 10,000 sales representatives" in order to provide a more understandable picture and to match data of the companies analyzed. As explained in the supplement, a larger sample is applied to the Amway/Quixtar data.

The raw data from Nuskin is from its report entitled "1998 Actual Average Incomes." Nuskin was required by the Federal Trade Commission to make disclosures due to two violations regarding false income claims. Nuskin only calculated the incomes of those who were "active" one month of 1998. *The totals of those who joined but dropped out during the year were excluded.*

Nikken's and Melaleuca's numbers come from reports that each company has provided to distributors in the past. Both also counted only "active" distributors. Melaleuca only calculated the incomes of those who were active during *all 12 months* of 2002. Those who dropped out before a year were excluded. *Melaleuca has reported that more than half of all its distributors drop out within a year.*

Melaleuca's numbers were also obscured by not providing exact numbers on the percentage of sales representatives in each level out of the *total* sales representatives, only their percentages within each of two major groups. However, the company stated that approximately one in five who stay in for a year move from the bottom group to the higher one. The PSA analysis is based on that general breakdown of the sizes of the two main groups.

Reliv, Arbonne's and Free Life's numbers come directly from recent data currently provided on their official websites.

Cyberwize.com's data comes from the "Income Disclosure Statement for Cyberwize.com 2003-2004" posted on the Cyberwize.com website. This company, like others, limited data only to those active sales representatives who had made a purchase during the year and did not include "terminated" sales people.

The data source for *Amway/Quixtar is Average Annual Income for IBO's in North America, 2001 Average Annual Earnings in U.S. Dollars,* © 2002 Quixtar Inc., which had been posted on the Quixtar website. (Note: In Amway/Quixtar terms, a distributor (salesperson) is called an "IBO" (independent business owner). "Active" in the Quixtar disclosure means an IBO

 © 2005 Pyramid Scheme Alert

attempted to make a retail sale, or presented the Independent Business Ownership Plan, or received bonus money, or attended a company or IBO meeting in the year 2000.)

Data Analysis: Breaking the MLM Secret Code

Data Disclosed by Companies

All data used in the analysis of rebate income were disclosed and published by the MLM companies themselves. The PSA analysis simply translates this data into a more understandable format. Data become far clearer when they are organized in a per-10,000-sales-representatives format. By translating this data into a simpler and clear format, the MLM code is broken. The absurdly small payouts to the vast majority at the bottom of the chain and the enormous payouts to the handful of individuals at the top, which are hidden in the MLM formatted data are starkly revealed.

MLM companies sought to make the figures appear more favorable by limiting the calculations only to the sales representatives who stay "active" for a year, or only counting those that are active during one selected month or several months. Using that selective method, as each of the MLM companies did, the average incomes of those at the bottom were *increased.* The proportion of those at the top level was similarly *decreased.* Had *all* distributors been counted, or if all distributors who participated *over a multi-year period* were included, a truer failure rate would be revealed. As bad as the figures are, they would be far worse if all participants were included and a longer time frame applied.

Method of Calculations

- The use of a sample of 10,000 translates the abstract and difficult to understand data published by the MLM into a comprehensible and comparable format. When the percentages of distributors in each "level" (Diamond, Bronze, Director, etc.) are disclosed by the MLM company, the actual numbers of people in each level can be determined by applying them to a 10,000-person sample. For example, Nuskin revealed that 0.66% of all "active" distributors were at the "Lapis" level. In a sample of 10,000, this means that 66 people out of 10,000 would be at that level.
- With the sample divided into actual numbers for each of the levels, and an average payment per distributor in each level disclosed by MLM company, the total dollars paid to each level, per 10,000, can be calculated. The average payout per distributor in each level is multiplied by the total number, per 10,000, in each level.
- With the total payout to each pin level determined, the percentage of the sum total payout that is paid to each level is calculated by dividing the total of each level into the sum total payout to all levels.

Revenue, not Profits

The income numbers are not "profits." The costs of doing business (buying inventory, car expenses, phone charges, purchase of marketing materials, training seminars, etc.) are not deducted, nor are taxes. Actual net income, where any exists, would be much lower than the numbers presented.

The fact that average income does not equate to "profit" holds true even for the highest average incomes reported for the few at the top of the MLM sales organizations. In a May, 2004 exposé of the Amway/Quixtar sales program, *NBC Dateline* disclosed that the majority of income to

 © 2005 Pyramid Scheme Alert

Amway's top distributors did not come from commissions on Amway products. *Rather, their main source of income was from selling books, tapes and seminar registrations to new recruits.* Whistle-blowers told *NBC Dateline* that *the costs of being a top promoter at Amway exceeded the income* and that without the "secret" other income source, these "kingpins" would lose money. The whistle-blowers interviewed on *Dateline* also charged that the sales of books, tapes and seminar registrations are organized as a closed pyramid scheme. The goods are never retailed outside the sales force. Upper levels can earn money from the sales of these items to lower levels, who in turn do the same.

Retail Sales Costs and Income Excluded

Retail sales revenues are also not calculated in the analysis of the eight companies. *Part 3* of the report addresses the retail sales sector of the MLM "income opportunity" using a much larger sample of companies.

Since no projections of retail profits are included in this report, any costs associated with retail selling such as inventory purchases, marketing, travel, training, free samples, discounts, etc. are also not calculated. If these costs were factored with whatever small amount of retail revenue the sales representatives earned, the losses would be much larger than presented.

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Nuskin

Data Source: " Nuskin's "1998 Actual Average Incomes" Report

Level	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/Group	Average Payment per Distributor in each Level	Total Payment per Level/ per 10,000 Distributors	% of Total Payments per Level/Group
Blue Diamond	16	.16%	$480,403.97	$7,686,464	52.46%
Diamond	9	.09%	$154,581.68	$1,391,235	9.49%
Emerald	8	.08%	$53,422.40	$427,379	2.91%
Ruby	19	.19%	$27,070.91	$514,347	3.51%
Lapis	66	.66%	$12,408.99	$818,993	5.59%
Gold	111	1.11%	$6,611.44	$783,870	5.35%
Total per Group	229	2.29%	$50,752.35	$11,622,288	79.31%
Executive	266	2.66%	$4,622.03	$1,229,460	8.39%
Qualifying Executive	46	.46%	$2,988.98	$137,493	0.94%
Distributor	880	8.8%	$1,888.20	$1,661,616	11.36%
Distributors who did not receive commis-sions	8,578	85.78%		$0.00	0
Total per Group	9,770	97.7%	$310	$3,028,569	20.69%
Totals	10,000	100%	$1,465	$14,650,857	100.00%

For each 10,000 Nuskin distributors:

- Just 16 out of the 10,000 individuals received 52% of total company payments.
- The mean average payment to the bottom 99% of Nuskin distributors was $7.43 per week. (before expenses and taxes are deducted - resulting in a significant loss.)
- The top 1% of the 10,000 received 74% of all company payments.
- The bottom 86% received no company payments at all.
- The mean average payment to *all* the Nuskin distributors was $28 per week - before expenses and taxes.

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Nikken

Data Source: Nikken USA's Average Wellness Consultant Income Sheet Annual Income Statistics 2000

Levels	No. in each Level per 10,0000 Distributors	% of all Distributors in each Level/Group	Average Payment per Distributor in each Level	Total Payment per Level/Group per 10,000 Distributors	% of Total Payments per Level/Group
Royal Diamond	1	0.01%	$1,024,466	$1,024,466	16%
Diamond	4	0.04%	$265,145	$1,060,580	16%
Platinum	20	0.20%	$47,313	$946,260	14%
Gold	50	0.50%	$15,192	$759,600	12%
Silver	555	5.55%	$2,904	$1,611,720	25%
Total Per Group	630	6%		$5,402,626	83%
Bronze	293	2.93%	$969	$283,917	4%
Executive	950	9.50%	$390	$370,500	6%
Senior	2,729	27.29%	$73	$199,217	3%
Direct	5,398	53.98%	$52	$280,696	4%
Total Per Group	9,370	94%	$121	$1,134,330	17%
Totals	10,000	100%	$654	$6,536,956	100%

For each 10,000 Nikken distributors:

- Just 25 out of the 10,000 individuals received 46% of total company payments.
- Less than 1% of the 10,000 (75 people) received 58% of all company payments.
- The bottom 94% received only 17% of the payments.
- The mean average payments to the bottom 99% of Nikken distributors was $5.32 per week (before expenses and taxes are deducted - resulting in a *significant loss*).
- The mean average payments to *all* the Nikken distributors was $12.57 per week - before expenses and taxes.

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Melaleuca

Data Source: Melaleuca's 2002 Annual Income Statistics, Melaleuca Marketing Executives

Levels	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/ Group	Average Payment per Distributor in each Level	Total Payment per Level/Group per 10,000 Distributors.	% of Total Payments per Level/ Group
Exec. Director	30	.3%	$126,322	$3,789,660	35.23%
Sr. Director	52	.52%	$33,681	$1,751,412	16.28%
Director V	16	.16%	$14,816	$237,056	2.20%
Director IV	38	.38%	$10,718	$407,284	3.78%
Director III	94	.94%	$6,872	$645,968	6.00%
Director II	268	2.68%	$3,567	$955,956	8.88%
Director	1,502	15.02%	$1,219	$1,830,938	17.02
Total per Group	2,000	20.0%	$4,809	$9,618,274	89.4%
Exec. III	1,064	10.64%	$393	$418,152	3.88%
Exec. II	1,536	15.36%	$166	$254,976	2.37%
Mktg. Exec.	5,400	54%	$86	$464,400	4.31%
Total Per Group	8,000	80.0%	$142	$1,137,528	10.6%
Totals	10,000	100%	$1,075	$10,755,802	100%

For each 10,000 Melaleuca distributors:

- 82 people out of 10,000 (less than 1% of the total) received over one-half of the total company payout. (The other half of the payout was divided among 9,918 others.)
- Just 30 individuals received 35% of the total, each one receiving over $2,400 per week.
- The mean average payment to of the bottom 99% of Melaleuca Distributors who remained active for one full year was $9.66 per week (before expenses and taxes are deducted - resulting in a *significant loss*).

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Arbonne International

Data Source: "The Company Independent Consultant Compensation Summary" (from Arbonne official Website, http://www.arbonne.com/company/iccs.html) June 29, 2005

Level	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/Group	Average Payment per Distributor in each Level	Total Payment per Level/ per 10,000 Distributors	% of Total Payments per Level/Group
National Vice Presidents	4	0.04%	$330,516.40	$1,322,065.60	29.77%
Regional Vice Presidents	16	0.16%	$75,715.20	$1,211,443.20	27.27%
Area Managers	58	0.58%	$17,934	$1,040,172	23.42%
District Managers	214	2.14%	$3,517.60	$752,766.40	16.95%
Consultants	138	1.38	$829.60	$114,484.80	2.58%
Total per Group	430	4.3%		$4,440,932.00	100%
Consultants who did not redeive any company rebates	9,570	95.7%	$0	$0	0%
Total	10,000	100%		$4,440,932.00	100%

For each 10,000 Arbonne distributors:

- Just 20 out of the 10,000 individuals received 57% of total company payments.
- The mean average payment to the bottom 99% (99.22%) of Arbonne distributors was $1.68 per week. (before expenses and taxes are deducted - resulting in a significant loss.)
- The top 1% (.78%) of the 10,000 received 80% of all company payments.
- The bottom 96% received no company payments at all.
- The mean average payment to *all* the Arbonne distributors was $8.54 per week - before expenses and taxes.

Arbonne's "The Company Independent Consultant Compensation Summary" states: "Independent Consultants can buy Arbonne products from the Company at wholesale prices for resale to Clients or for personal use... Most Consultants personally use the products in addition to retailing them. As a result of these different scenarios, Arbonne does not provide an estimate of average or actual Consultant income from retail sales in this compensation summary.

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Reliv

Source: "2003 EARNINGS STATISTICS" (from Reliv official Website, http://www.reliv.com/docs/2003EarningsDisclosure.pdf)

Level	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/Group	Average Payment per Distributor in each Level	Total Payment per Level/ per 10,000 Distributors	% of Total Payments per Level/Group
Presidential Director	21	.21%	$158,128.92	$3,320,707	47%
Master Director	40	.40%	$37,581.48	$1,503,259	21%
Senior Director	43	.43%	$18,189.72	$782,158	11%
Key Director	138	1.38%	$6,748.56	$931,301	13%
Director	458	4.58%	$1,307.88	$599,009	8%
Total per Group	700	7%		$7,136,434.00	100%
Retail Distributor, Affiliate, Key Affiliate, Senior Affiliate, Qualified Master Affiliate and Master Affiliate	9,300	93%	$0	$0	0%
Total	10,000	100%		$7,136,434.00	100%

For each 10,000 Reliv distributors:

- Just 21 out of the 10,000 individuals received 47% of total company payments.
- The mean average payment to the bottom 99% of Reliv distributors was $2.97 per week. (before expenses and taxes are deducted - resulting in a significant loss.)
- The top 1% of the 10,000 received 79% of all company payments.
- The bottom 93% received no company payments at all.
- The mean average payment to *all* the Reliv distributors was $13.72 per week - before expenses and taxes.

Reliv's "2003 EARNINGS STATISTICS" does "not include profits earned through retail sales of product to customers or wholesale profits from sales of product to downline Distributors purchasing at lower discounts... but, according to Reliv, "it is fair to state that retail and wholesale profits from customers and downline Distributors constitute a major form of income for Reliv distributors." Reliv says it "has no current ability to estimate those types of income."

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Free Life International

Data Source: Free Life's 2004 Annual Income Statistics
(http://freelife.com/info/makemoney/incomestats/2004incomestatistics.pdf_)

Levels	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/ Group	Average Payment per Distributor in each Level	Total Payment per Level/Group per 10,000 Distributors.	% of Total Payments per Level/ Group
Royal Ambassador	17	.17%	$549,662	$9,344,254	27%
Ambassador	289	2.89%	$59,245.21	$17,121,865	49 %
Director V	51	.51%	$13,666.98	$697,015.98	2.%
Director IV	102	1.02%	$12,756.02	$1,301,114	4%
Director III	204	2.04%	$7,255.92	$1,480,207.60	4%
Director II	306	3.06%	$3,633.45	$1,111,835.70	3%
Director I	731	7.31%	$2,380.96	$1,740,481.70	5%
Total per Group	1,700	17.0%		$32,796,773.98	94 % (rounded)
Director	581	5.81%	$1,044.37	$606,778.97	1.74%
Executive IV	498	4.98%	$711.89	$354,521.22	1%
Executive II.	3,569	35.69%	$234	$835,146	2.4%
Executive	3,652	36.52%	$62.19	$227,117.88	.65%
Total Per Group	8,300	83.0%		$2,023,563.90	6% (rounded)
Totals	10,000	100%	$1,075	$34,820,337.88	100%

For each 10,000 Free Life distributors:

- 17 people out of 10,000 received over one-fourth of the total company payout.
- The top 3% of the total received over 75% of the total company payout. Each one in the top 3% earned on average $1,700 per week.
- The remaining one/fourth is divided among the 9,694 others.
- The mean average payment to of the bottom 97% of Free Life Distributors who remained active for one full year was $16.57 per week (before expenses and taxes are deducted - resulting in a *significant loss*).

 © 2005 Pyramid Scheme Alert

Pyramid Scheme Alert Data Analysis
Robert L. FitzPatrick, Pres. © 2005

MLM Company: Cyberwize.com

Data Source: Income Disclosure Statement for Cyberwize.com 2003-2004 on the Cymberwize.com website (August, 2004)

Level	No. in each Level per 10,000 Distributors	% of all Distributors in each Level/Group	Average Payment per Distributor in each Level	Total Payment per Level/ per 10,000 Distributors	% of Total Payments per Level/Group
Diamond	1	.01%	$604,202	$604,202	10.17%
Platinum	3	.03%	$263,811	$791,433	13.32%
Gold	9	.09%	$72,296	$650,664	10.95%
Silver	15	.15%	$35,017	$525,255	8.84%
Bronze	34	.34%	$13,744	$467,296	7.86%
Senior Director	73	.73%	$5,808	$423,984	7.14
Director	300	3%	$2,095	$628,500	10.58%
Total per Group	435	4%		$4,091,334	69%
Associate	428	4.28%	$752	$321,856	5.42%
Qualified IBO	108	1.08%	$350	$37,800	.636%
Active IBO	6,117	61.17%	$208	$1,272,336	21.42%
IBO	2,911	29.11%	$83	$214,613	3.61%
Total per Group	9,564	96%	$193	$1,846,605	31%
Totals	10,000	100%	$594	$5,937,939	100.00%

For each 10,000 Cyberwize distributors:

- 34% of the entire payout went to just 13 individuals out of each 10,000 "active" sales representatives.
- The mean average income of the bottom 99% of the active Cyberwize sales representatives was $5.61 per week (before expenses and taxes are deducted - resulting in a *significant loss*).
- Cyberwize.com's disclosure document states that 67% of all active sales representatives made no commissions; that is, out of each 10,000, 6,700 made no rebate income.
- The bottom two levels of the pyramid, out of a total of 11 levels, constitute 90% of all the sales representatives.
- Out of each 10,000 sales people, the top 4 individuals earned as much in total as the bottom 9,000 combined.

 © 2005 Pyramid Scheme Alert

Additional Data on Rebate Income Averages

- The 2002 annual report of the MLM company, Usana, disclosed net sales of $133,776,000 with payments to the sales force of $51,174,000. At year-end the company reported that it had 66,000 "Active Associates" (those who purchased product in the last three months). This means that on average each Sales Associate bought $2,027 of Usana products in a year's time and earned an average of $775 or $14.90 a week (before expenses are deducted). *Note: As bad as the income average is, the real figures are actually much worse. Like other MLMs, Usana distorts the real picture by publicizing the full payments made over an entire year, but only factoring the number of "active" distributors for just one-fourth of the year. Thousands joined and paid and then dropped out. Their payments are counted as company revenue, a portion of which is paid out in commissions. But they are excluded when the "average" payment is calculated.*
- In year 2000, Market America, another large MLM, paid out $60.6 million in commissions to 81,379 "active" distributors *That works out to about $15 a week average gross income,* before taxes are taken out and expenses are paid and products are purchases. *(See the effect of using this method of calculating only "actives" in the bullet point above on Usana.)*
- According to the Year 2000 Annual report of the MLM company, Pre-Paid Legal Services, the company had paid out $139,891,000 in sales commission over the previous five-year period. The total number of people who had been PPD sales representatives during this time was 472,189. That averages out to $5.70 per week per sales rep, before taxes, training and other expenses are deducted. *When company training costs are deducted, the gross income average falls to $2.10 per week.*

© 2005 Pyramid Scheme Alert

Summary of Rebate Income Findings

A review of the payouts of six of the larger and best-known multi-level marketing companies and one other more recently formed MLM reveals that more than 99% of *all* distributors do not earn a profit from company rebates. Additionally, the millions of dollars that the distributors pay the companies for product, training, fees and marketing materials are transferred in the form of rebates to a tiny group at the top. The concentration of payments to a handful of organizers is consistent and extreme.

MLM Companies	% of Distributor in Top level and the % of Total Payout they Received	Average Income of Top Level	% of Top Distributors Earning at least 50% of Total Payout and the Actual % of Total Payout They Received	Average Income of Top Distributors Earning at least 50% of Total Payout	Average Income of the Bottom 99% of All Distributors, Annually/ Weekly
Arbonne	.04% (1 in 2,500) of all Distributors Received 30% of Total Payout	$330,516	.26% (1 in 390) received 57% of total payout	$126,675	$87.36 per yr. $1.68 per wk.
Cyberwize	.01% (1 in 10,000) of all Distributors Received 10% of Total Payout	$604,202	.16% (1 in 625) received 51% of total payout	$49,014	$291.72 per yr. $5.61 per wk.
Free Life	.17% (17 in 10,000 of all Distributors Received 27% of Total Payout	$549,662	3.05% (3 in 100)received 76% of total payout	$86,774	(Bottom 97%) $861.79 per yr. $16.57 per wk.
Melaleuca	.3% (1 in 330) of all Distributors Received 35% of Total Payout	$126,322	.82% (1 in 120 received 52% of total payout	$67,574	$502.32 per yr. $9.66 per wk.
Nikken	.01% (1 in 10,000) of all Distributors Received 16% of Total Payout	$1,024,466	.75% (1 in 135) received 58% of total payout	$50,545	$276.64 per yr. $5.32 per wk.
Nuskin	.16% (1 in 625) of all Distributors Received 52% of Total Payout	$480,403.97	.16% (1 in 625) received 52% of total payout	$480,404	$386.36 per yr. $7.43 per wk.
Reliv	.21% (1 in 475) of all Distributors Received 47% of Total Payout	$158,128.92	.61% (1 in 165) received 68% of total payout	$79,081	$154.44 per yr. $2.97 per wk.

- In every company, 50% of the total company payments went to less than 1% of all distributors.
- In one company, 76% of total company payouts went to 3% of all the distributors.
- In several companies, less than 1/2 of 1% (1 in 200) of distributors received more than 50% of total company payments.
- Bottom 99% of six companies received less than $10 per week (range of averages were from $1.68 to $9.66) in average gross income, *before taxes, expenses and product purchases*.
- In several cases, the bottom 80% of distributors earned no income at all.

 © 2005 Pyramid Scheme Alert

The main promoters in the top brackets are often advertised as if they represent the actual potential income of *any* new recruit. In fact, each year, the new recruits – who make up the majority of all the distributors – are a revolving group, quitting and being replaced by new hopefuls. *The annual dropout rates of all MLM companies range from 50% to 75%.* In the case of Nikken, for example, the average tenure of the Directs and Seniors levels of the hierarchy – who make up 81% of the total sales force – is less than a year overall. This high turnover rate occurs among the lower ranks of the hierarchy where the vast majority of recruits are always positioned, and they are the people who account for the majority of company product purchases.

The money that this revolving-door group invests – and earns no profit from – is the source of the high incomes to those few at the top each year. Those people remain in their insider positions year after year, benefiting from the losses of all those who come and go below them.

Three Key Facts for Understanding MLM Rebate Payouts

- The disparity in rebate payout in MLMs is not between high pay for executives and low pay for entry level workers, as is found in many corporations. In MLMs it is between extraordinary high pay for a tiny group and *no net profit at all* for all others. The very low incomes of the vast majority turn out to be significant *losses* when business expenses are included.
- *The rebates paid to the top promoters in recruitment-based MLMs come directly from all the other distributors who lost out*, not from "customers" of the company, as in a normal corporation. One group's money is *transferred* to another's *inside the organization.* The recruitment-based MLMs have no sustainable external customer base - just a revolving, churning group of hopeful recruits and their friends and family who come and go each year. *It is their money that is being transferred to the top.*
- As statistically small as they are, the percentages of those who get to the "top" in the examples offered in this report do not represent the "odds" for succeeding:

  -- 16 out of 10,000 at Nuskin
  -- 1 in 10,000 at Nikken
  -- 30 in 10,000 at Melaleuca
  -- 4 in 10,000 at Arbonne
  -- 21 in 10,000 at Reliv
  -- 17 in 10,000 at Free Life
  -- 1 in 10,000 at Cyberwize.com
  -- 1 in 10,000 at Amway/Quixtar (For Amway, this figure is not just for the top level, but the top set of levels. Only 1 out of each 150,000 active participants reaches the top level. The "Diamond and above" levels, which Amway holds out as a feasible goal for all new recruits to attain, is held annually by less than 1 in 10,000 of all participants. (Full data is presented in the "Special Supplement,")

  True "odds" for success in MLM are far worse than the above figures. Each person who joins does not have an equal chance, as they would in a lottery or any other activity based on "odds." The people at the top of a recruitment-based MLM win every day, *based on their position,* not on "odds." When *all* recruits are included in the calculations and the incomes of the insiders at the top are excluded (a weighted average), the real chance of success for a new recruit is shown to be far worse than odds at a Las Vegas gambling table. *When all the participants over a multi-year period are included in the calculations – all of whom sought a winning position – the failure rate rises to a point that is too small to be graphically illustrated.*

 © 2005 Pyramid Scheme Alert

Part 3: Exposing the Myth of MLM Retail Income

The previous charts show that virtually no MLM recruits earn a profit from rebates or commissions from MLM companies. Enormous amounts of money are paid, but they accrue overwhelmingly to a tiny number at the top of the pyramid organization.

Can the recruits earn a profit retailing the products on the open market to consumers? The figures from more than 20 representative MLM companies reveal that retail-based income is also a myth. Before taxes and expenses and factoring that every sales person sells his/her entire inventory at full retail price without ever discounting, the maximum average retail income would be only $12 a week. After expenses and factoring the realities of discounts, free samples and personal usage, the average income approaches zero or a significant net loss.

The Legal Significance of Retailing

Even though the Federal Trade Commission uses the percentage of retail-based income as a defining characteristic in prosecuting MLM pyramid schemes, MLM companies are not required to disclose to new recruits or to the government the percentages of their products that are ultimately retailed. When the FTC has prosecuted MLM pyramids, it has had to show that the company is not adequately retailing. This requires time-consuming research and games of hide-and-seek with the MLM company regarding data on retailing.[8]

In its prosecution of Equinox International, rather than go through an enormously expensive effort to ascertain retail sales levels, the FTC used a simple mathematical deduction to determine the level of retailing that would establish legality. Once that level was determined it relied on other factors, most of which are listed later in this report, and anecdotal evidence from distributors to base its claim that the required level was not being achieved nor any level even close to it.

The 70% Retail Benchmark

The formula involves adding the company's total production costs, marketing expenses, general overhead and retail profit (based on the maximum gross profit without discounting). The FTC model allowed that only half the rebates paid to the sales representatives had to be tied to retail sales, so only the value of half its rebates were added to this sum. With this total representing all costs that the law would require to be covered by retail sales, the FTC could project that 70% of all Equinox sales to its sales representatives would have to be retailed for the company to meet its legitimacy test. The FTC asserted that it believed no more than 20% of Equinox's purchases by its sales force were ever retailed.

---

[8] The non-retailing factor is a key element in causing the consumer losses, since recruitment-based profits can only be achieved by a rare few participants that are positioned at the top of the sales pyramids. Yet, the MLM industry is now seeking to escape prosecutions that are based on the factor of the retail sales level. A bill, written by the Direct Selling Association, has been introduced in Congress to fully legitimize "non-retailing" multi-level marketing companies. The bill, HR 1220, is a bold effort to overturn past court rulings, overrule state statutes against pyramid selling schemes and reverse decades of pyramid scheme regulatory policies. The effect of this bill would be to allow and legalize business practices that are currently treated as pyramid scheme fraud. It is promoted by the Direct Selling Association (DSA), which has defended pyramid sales schemes that were prosecuted by state and federal government. Several of its former members, such Trek Alliance and Equinox Int'l, were recently shut down by the FTC as pyramid schemes for the very practices this bill seeks to legalize.

 © 2005 Pyramid Scheme Alert

Because most MLMs pay a large percentage of their total wholesale revenues to the upline organizers in rebates, most will correspondingly require 70% retail sales level requirements when the test is applied to them. Using its year 2000 annual report, Herbalife International, one of the largest and best established MLMs, was shown to require 80% retail levels to establish legitimacy when the FTC formula was applied.

There are many precedents, other than the FTC's test, for setting 70% as a minimum required retail sales level for MLMs to prevent MLMs from operating as pyramid recruitment scams.

- Amway pleaded to the FTC in 1979 that it required its distributors to resell at least 70% of the products they have purchased each month. Amway told the court, its "70% rule" had been in existence since the beginning of Amway and that it enforces the rule. The "70% rule" supposedly prevented Amway from loading up distributors solely on their own personal purchases. In recent years, Amway now claims that sales at a wholesale level from one distributor to another are the same as retail sales and meet the requirement. The FTC does not currently accept this claim from any MLM.
- Additionally, this 70% standard has been applied in four cases in North Carolina prosecuted by the NC Attorney General's Office. The four companies include Club Atlanta Travel, Destiny Telecomm International, Inc., Tele-Card International, and International Heritage, Inc. These four companies had enrolled 40,000 distributors in North Carolina alone. Destiny Telecomm International, as one case in point, was a California company that marketed discount phone cards. Upon joining the Destiny Program, each participant purchased at least one Destiny phone card after which they were told they could earn commissions upon the recruitment of other participants. In the court settlement, Destiny agreed that "at least 70% of all North Carolina sales shall be retail sales to persons who are not connected in any way to the Destiny sales force." The agreement also excluded from the 70% portion sales to individuals who subsequently became Destiny representatives.

Retailing Realities

- The actual retail sales levels of the vast majority of MLMs is exemplified by Amway/Quixtar, the oldest and largest of all multi-level marketing companies. Amway was compelled by government order to provide its retail sales data. It disclosed that less than 20% of its products are purchased by anyone other than its own sales representatives.
- Melaleuca and most other MLM companies stress the practice of "becoming your own customer," that is, buying the company's products and then recruiting other sales representatives who will purchase in a similar manner *for their own use.* Virtually all MLM companies require a minimum monthly purchase level by their distributors. None of the four companies in the study pays rebates based on retail sales, only on the purchases of downline distributors.
- Most recently, and in obvious response to the actions of regulators that focus on retail sales levels, some MLMs will require the sales representatives to have a minimum number of retail customers. This does not mean that sales representative earn a true retail profit or have a sustainable customer base, only that they have a few retail customers that function as fig leaves. *For example, in the case of Pre-Paid Legal, one of the largest MLMs, the average number of retail customers per sales representative is just 4 customers, an insufficient customer base for the sales representative to earn a profit.*

 © 2005 Pyramid Scheme Alert

The Retail Income Myth Revealed

Data from 21 MLMs[9]

Company	No. of Sales People	Av. % Gross Prof.	Total "Projected" Retail Sales	Total "Potential" Retail Profits	Av.Ann Ret. Prof.	Av. Wkly Ret. Prof.
American Image Marking	75,000	50%	$90,000,000	$45,000,000		
Advantage Marketing Systems	37,000	37%	$13,492,063.49	$4,992,063		
Amway	2,000,000	32%	$5,882,352,941	$1,882,352,941		
Celltech	34,000	35%	$38,461,538	$13,461,538		
Diamite	43,000	40%	$83,333,333	$33,333,333		
Discovery Toys	25,000	55%	$166,666,667	$91,666,667		
Enrich International	75,000	30%	$107,142,857	$32,142,857		
Herbalife	250,000.00	25%	$102,000,000	$25,500,000		
Japan Life America Corp.	4,500	18%	$8,536,585	$1,536,585		
Matol Botanical	172,000	32%	$375,000,000	$120,000,000		
Melaleuca	150,000	37%	$333,333,333	$123,333,333		
Nanci Corporation	50,000	27%	$82,191,781	$22,191,780		
Neways	35,000	50%	$90,000,000	$45,000,000		
Nikken	1,035,000	20%	$1,250,000,000	$250,000,000		
Noevir	40,000	30%	$42,857,143	$12,857,143		
NSA	50,000	22%	$466,666,667	$102,666,667		
Nutrition for Life	30,000	30%	$21,428,571	$6,428,571		
Oxyfresh	13,000	29%	$18,309,859	$5,309,859		
Reliv	48,000	32%	$73,529,412	$23,529,412		
Shaklee	1,000,000	23%	$596,103,896	$137,103,896		
Watkins	50,000	45%	$181,818,182	$81,818,181		
Totals	5,216,500	(av.)33% Gross Prof.	$10,023,224,830	$3,307,664,194	$634.08	$12.19

[9] Raw Data Source: *Multi-Level Marketing, the Definitive Guide to America's Top MLM Companies*, Second Edition. Compiled by Will Marks, 1994, Arlington, Texas, The Summit Publishing Group.

 © 2005 Pyramid Scheme Alert

Summary of Retail Income Findings

- Findings are based on a 1994 sample of 21 multi-level marketing companies, large and small.
- The sample constituted 5.2 million sales people and over $10 billion in "projected" retail sales.
- The average potential retail sales gross profit for all companies was 33%.
- Maximum Average Gross Profit for all these sales people was $12.19 per week, before expenses and taxes.
- This $12 a week would be possible only if all sales people sold *all* their inventory on a retail basis, purchased none of the goods for themselves, never gave away any samples and were able to sell all the goods at full retail margin without discounting at all.
- *When actual costs are factored, including inventory, samples, sales costs, and discounting, and true volume of retailing are calculated, the average net profit would be near zero or a significant net loss.*

Bottom Line: No Rebate Profit, No Retail Profit

The lack of *retail* income potential –$12.19 per week maximum on average – must now be seen along with the findings of the *rebate* income:

- The mean average payment to the bottom 99% of "active" of the six representative companies in this report was less than $10 per week.

PSA's report reveals that actual "income opportunity" in the major MLMs – from both rebate payments and retail sales revenue – is an abysmal record of losses for millions and extraordinary payoff to a handful of promoters at the top of the pyramid sales organizations.

MLM's claim to legitimacy – based on an "income opportunity" offered to the average consumer – is false and unfounded. The other claim of the business model – that it is a form of "direct selling" – is also revealed as false.

 © 2005 Pyramid Scheme Alert

The Myth of Door-to-Door Selling

The MLM sales model is said to be composed of thousands of "door to door" resellers. This claim contradicts the everyday experience of most people. The door-to-door salesperson is nowhere to be found in the modern American neighborhood. Few people are at home during the day or have time in the evening to entertain sales representatives. Security concerns do not support door-to-door sales. The internet, mass distribution, big-box discount stores, mail order catalogues and telemarketing all have contributed to the demise of the door-to-door salesperson.

Beyond these broad indicators, a confluence of ten factors within the MLM business model and inherent in its practices weighs against MLM sales representatives being able to retail their products or services "door to door." The factors negating retailing are matched to others that encourage *recruiting*. They include:

1. Inadequate Gross Profit and High Price of Products Restrict Retailing

Nikken, for example, offers only a maximum of only 20% gross profit on suggested retail prices of its entire product line. Considering the costs involved and the nature of the products, this small gross profit is an inadequate incentive to support necessary investments by distributors in retail marketing.

Out of this potential maximum of 20% gross profit, a distributor must finance the tasks of prospecting, making sales presentations, ongoing business investments, providing customer support and marketing literature, providing free samples, carrying some inventory, at least for demonstrations, and making some deliveries of the product (unless the product is purchased from Nikken directly). He/she may have to collect payment and take back returned goods as required.[10] Other costs that must be covered by this small gross profit include business licensing, accounting (Nikken itself charges accounting fees ranging from $24 to $360 a year depending on rank)[11], travel, phone, computer and other technology fees, etc.

A retail margin of at least 50% or (100% or more mark-up over wholesale cost) is needed to cover product and operating costs and allow for a reasonable profit. Companies such as Avon offer retail margins of this amount.

Beyond an inadequate gross margin, the retail-selling price must be competitive to comparable products. A perusal of MLM goods reveals many to be far more expensive than comparable goods sold in stores.

2. Limited Choice to Consumer Reduces Retailing Opportunity

Choice is restricted in the direct "person-to-person" method of selling and more people prefer to purchase goods of this type in stores where there is wider choice and no pressure upon personal relationship.

3. Marketing Policies Restrict Retailing

Most MLMs place severe restrictions on the marketing activities, which raise retail sales costs and limit the exposure of the sales people. These restrictions include strict prohibitions against

---

[10] "Customer Appreciation Program (CAP)/Nikken Shopping Network (NSN)...allows retail customers to order directly from the Internet, with the sales credit assigned to their distributor. *The distributor is responsible for handling any product returns.* (Nikken Distributor Reference Guide Update, Policies/Procedures, ©1999, p. 2)

[11] Nikken Distributor Guide Update, Policies and Procedures 10/99 , p. 17.

 © 2005 Pyramid Scheme Alert

displays in retail stores and mass advertising. Additionally, the MLM company itself does not engage in national advertising to support the brand or educate the customer about the product or the company. This burden and cost are carried entirely by the individual sales representative.

4. No Retail Sales Training Offered

The typical MLM company offers little training or support for retail selling. The focus and priority are placed on training, motivating and rewarding the recruitment of more and more sales people.

5. Nature of Products Makes Retailing Difficult

Some MLM products are controversial in nature. For many years, MLMs marketed weight loss products containing the now-banned supplement ephedrine. Referring to Nikken's products that use "therapeutic magnets," a perusal of the Internet turns up disputes about the value and efficacy of magnet technology, including scientific challenges and lawsuits. These controversies and challenges result in increased sales effort and time and the need for greater product knowledge and training. In other cases, the MLM products are undifferentiated "me-too" products in the "pills, potions and lotions" categories that characterize large sectors of the MLM business.

6. Competitive Product Availability Prohibits Retailing

Many MLM products are available at lower cost from other sales outlets, including retail stores and the Internet. Nikken-branded products, for example, are also available from current and ex-distributors at discounted prices.

7. Proliferation of Distributors Dilutes Retail Sales Opportunity

A characteristic of nearly all MLM sales and marketing is that they advise sales representatives to solicit their closest friends and relatives to also become distributors. This is equivalent to a McDonalds' franchise owner seeking to set up competitive stores on the same street. The proliferation of additional distributors within the same social or geographical market must inevitably lead to retail discounting, a scenario that would severely damage retail sales efforts.

A strategy of encouraging each distributor to authorize more local competitors would only make business sense if overrides from the new competitor's *investments* were paid to the recruiter by the franchisor and outweighed the loss of retail business that the additional competitors would cause. This is precisely what the MLM compensation programs do.

8. Greater Long Term Benefits from Recruitment than Retailing

A sale by a MLM distributor to a retail customer is a one-time event with no assurance of any future purchases of that company's products and no assurance that the end-user will purchase more of the MLM goods from that distributor. A newly recruited distributor, on the other hand, is effectively locked into the sponsorship structure, and all future purchases of that new recruit will accrue benefits to the distributor who did the initial recruiting. Additionally, the new recruit, as opposed to the end-user, is often exposed to the MLM company's promotions and materials to enter an automatic monthly ordering program, recruit more distributors, buy additional inventory, etc., which the individual end-user is not.

9. Top-Loaded Pay Plan Rewards Recruiting

Most MLMs use a clever pay plan that pays more money – per sale – to the "upline" than to the people actually doing the work of selling the product or recruiting new sales people. So, in addition to the structure limiting the number of winners to a tiny few, the pay plan also insures

 © 2005 Pyramid Scheme Alert

that whatever money the "losers" invest goes immediately to those at the top. This is necessary since most of the recruits will quit in less than a year after experiencing significant financial losses.

10. Advancement Tied to Recruiting

Whatever opportunity exists in the scheme for profitability is based on being positioned high on the chain. Recruiting is the only way to advance to the higher levels where the leveraged high incomes can be gained.

 © 2005 Pyramid Scheme Alert

The Lure and the Hook

MLM companies divert attention from the flawed business model and the disastrous financial outcome suffered by participants by presenting a compelling and very alluring picture to recruits. Virtually all companies of this type in every country that they operate in make the same *alluring and misleading promises* to recruits:

- **Opportunity to earn "residual" income**, that is, ongoing commissions on the purchase by others whom you recruit or whom they in turn recruit. This expands earning power well beyond one's own personal efforts. *You can be freed from "wage slavery!"*
- **Continuous income without continuous work.** Most products are "consumable" goods that people might re-use month after month.
- **Extraordinarily high-income potential**, much higher than most salaries or professions would normally promise. This claim is based on the theoretical potential of expanded recruitment efforts of others. A typical presentation shows the potential of one distributor recruiting just five other people, who each recruit five, and this continues just seven "generations." The result is over 78,000 new sales representatives. Commissions on all of their purchases, the promotions claim, will go to that one salesperson at the top, month after month. *That person could be you! Does your current job offer that kind of income opportunity?*
- **Possibility of early retirement** provided by a continuous, residual income stream from the labors of others in your sales organization. *No need to work and save all your life!*
- **Personal freedom**, financial independence as a self-employed person. *No more bosses!*
- **Time flexibility and more free time.** *More time to spend with the children, to take vacations, and to do more in life!*
- **Security provided by self-sufficiency** against the many changeable and unpredictable factors in today's economy, including corporate downsizing, government cutbacks, inflation, corporate profit taking, increasing requirements for high tech competency in the job market and job discrimination against older workers. *You are protected!*
- **Opportunity to enter the business for a low initial investment of money.** *No risk!*
- **No need for specialized skills or higher education.** *Anybody can do it!*
- **No marketing expenses or "cold calls"** to strangers are required because your friends and associates are your first prospects. *Your first recruit is as close as your neighbor next door or your own mother in the next room!*

© 2005 Pyramid Scheme Alert

Blaming the Victims

Even as millions of consumers are solicited into MLM and then quit after losing money, most do not understand why they lost. They are shown the luxurious lifestyles of the top promoters and are told that "anyone can do it." The promoters convince them that they personally "failed" and that it was "their own fault." Most have no idea of the sheer scale of people joining, losing and then quitting. They are led to believe that they are unusual in their "failure." Consequently, they not only do not complain to the government authorities but they do not even warn friends or relatives to stay out of MLM. Shame and disappointment are covered up with silence. The recruitment program continues largely unabated.

As has been previously illustrated, the massive failure rates among those who invest in MLMs have almost nothing to do with the individual recruit. These multi-billion-dollar consumer losses are due to the pyramid business model. Retailing is unfeasible and the recruitment-based income plan is designed so that most will lose. It cannot be otherwise. For a few to win, basic mathematics requires all others to lose. *"Anyone" cannot do it.*

The "endless" chain schemes do not, of course, go on forever. Nor do they continue until they quickly exhaust all possible new recruits. While the schemes are structured as endless chains and make promises to new recruits as if they were "limitless" and could fulfill the promise of success to all, in practice, the chain keeps breaking at the bottom and being "repaired." Large-scale failure is, in fact, necessary. If most did not quit, but continued to recruit, the earth would soon be entirely filled with MLM distributors in a very short period of time.

The way the mathematical limitation works itself out is in the pattern of dropouts. Non-retailing MLMs don't fully or quickly saturate areas with members because most people quit within a year. All such schemes experience a 50-75% annual dropout rate.

Dropouts thwart the recruitment process at the lower levels. The people trying to build the downline are always dependent on others below to "duplicate" the process. When their new recruits become discouraged and drop out, the rebuilding process must start yet again. *And while the hopefuls engage in this constant rebuilding effort, they are also continuously paying money to the scheme and its organizers – in product purchases, training fees and marketing costs – as well as incurring other normal business expenses.*

With its ongoing operation, continuous enrollment of excited new recruits and public displays of wealth and success by the organizers, the organization appears to the uninformed as viable, stable, and successful. Most schemes can go on for many years by successfully recruiting new people to refill the bottom ranks, which become open as past recruits quit the business in "failure." Eventually, they must move to new markets, usually in other countries and some also use the ploy of changing their names in order to continue deceptive recruiting.[12]

---

[12] Pyramid Scheme Alert receives inquiries regularly from consumers asking about a "new" company called Quixtar, not realizing that Quixtar is just a new name for the largest and oldest of MLMs, Amway.

 © 2005 Pyramid Scheme Alert

Special Supplement
Amway/Quixtar Data and Analysis

The Myth of Income Opportunity in Multi-Level Marketing presented detailed analysis of four representative and typical MLM companies in which it was shown that *more than 99% of all participants never earn any net profit from rebates, commissions or bonuses.* Additionally, the data on 21 MLMs showed that, *on average, MLM participants do not earn retail sales profit.* The real chance for a new recruit to make a profit is absurdly small, too small to be termed an "income opportunity."

This supplement offers data and analysis of the Amway Company – now called Quixtar in North America – that reveals exactly the same results: *at least 99% of all distributors do not earn any profit at all.*

Amway/Quixtar is the oldest, largest and most prominent of all multi-level marketing companies, with revenue of approximately $4 billion. Amway and Quixtar are the same business with only superficial changes. The parent corporation of Amway and Quixtar is the same, Alticor. The top executives and managers of both operations are the same. The "kingpin" distributors are all the same. The product lines are the same, and the pay plan is essentially the same.

The Secret Business

Amway figures must be considered separately because a secret business is run by its top distributors that provides the majority of their income. This secret business has been disclosed in lawsuits and websites for many years. In May 2004, the highly respected national news program *NBC Dateline* brought hidden cameras into Amway/Quixtar recruitment meetings and exposed the scam. As the report showed, the Amway "kingpins" make most of their money by deceptively recruiting people, not from selling Amway products. At recruitment meetings the kingpins claim that they have become wealthy in the Amway business and that new recruits can also gain this wealth by joining the company as distributors (called IBOs). In fact, these kingpins are gaining huge profits from selling books, tapes and seminars to new recruits, which they tell them are needed in order to achieve "success." In reality, many at the top levels are in a *net loss position* (after expenses) from their Amway business. They are surviving only from money gained from recruiting.

This data reveals that the average incomes of the top levels of Amway/Quixtar are indeed smaller than other MLMs and the payout is less concentrated at the top.

 © 2005 Pyramid Scheme Alert

Amway/Quixtar pays the least to its top recruiters, but their incomes are supplemented by a secret and deceptive second business run by the recruiters – in collaboration with the corporation – in which they make millions selling "success tools" to the recruits. Amway's promoters stage huge rallies for recruits where many of these bogus "tools" are sold through a secret internal pyramid structure.

Company	% of total payout gained by those in approx. top 1%
Nuskin (top 1.18%)	74%
Nikken (top .75%)	58%
Melaleuca (top .98%)	54%
Cyberwize (top .62%)	51%
Arbonne (top .78%)	80%
Reliv (top 1.04%)	79%
Amway (top .9%)	**24%**

No data exist on the incomes gained from the secret "tools" business run by Amway/Quixtar kingpins, but the existence of this business – backed by the data showing that 99% of all distributors lose money – indicates a massive and global campaign of deception.

Lawsuits, Exposés, Consumer Protests, Tax Evasion, Defiance of Government Orders, Intense Political Influence-Peddling

Additional reasons why Amway/Quixtar deserves separate analysis regarding its claims about income opportunity include:

- Amway/Quixtar is the most controversial of all MLMs. Numerous private lawsuits, class action lawsuits and many consumer protest and exposé websites all charge deception about the income opportunity and the operation of a harmful pyramid scheme.
- Amway was sued by one of the largest companies in America, Procter and Gamble, of operating an illegal pyramid scheme and deceiving recruits about income opportunity.
- Amway/Quixtar has been the subject of an exposé news program on the most credible American news shows, *NBC Dateline* and *CBS 60 Minutes*, in which the company was accused of massive deception about actual income levels of recruits.
- Amway has a history of deception and illegal behavior:
  - In 1983, the Canadian government charged Amway and founders DeVos and VanAndel with tax evasion. Amway eventually pleaded guilty and paid a fine of $25 million – the largest ever imposed in Canada.
  - In the US in 1979, Amway was ordered by the Federal Trade Commission to halt its practices of price fixing and making exaggerated income claims.
  - Amway was subsequently found by the FTC to be violating the 1979-government order to stop making false income claims and was forced to make disclosures about actual income averages.
  - Amway was charged by the state of Wisconsin for making false income claims. An investigation by the Wisconsin Attorney General revealed that the upper levels of Amway distributors were, on average, showing a significant *net loss* on their tax returns.
  - Amway has engaged in large-scale political lobbying that could influence federal regulation of false income claims.

 © 2005 Pyramid Scheme Alert

- **Estimated Quixtar (Amway) Payouts - on a per 300,000 distributors basis**

Data Source for Analysis: "Average Annual Income for IBO's in North America, *2001 Average Annual Earnings in U.S. Dollars.*" ("Active" means an IBO attempted to make a retail sale, or presented the Independent Business Ownership Plan, or received bonus money, or attended a company or IBO meeting in the year 2000.) © 2002 Quixtar Inc.
Note: In Amway/Quixtar terms, a distributor (salesperson) is called an "IBO" (independent business owner).

Levels	No. in Each Level per 300,000	% of Active Distributors	Average Payment per Distributor	Total Payment Per Level, per 300,000	% of Total Payments per Level
Founders Exec. And Above	2	0.0007%	$982,154.00	$2,062,523.40	0.5%
Exec. Diamond and Above	13	0.0042%	$450,729.00	$5,679,185.40	1.4%
Founders Diamond	5	0.0018%	$227,400.00	$1,227,960.00	0.3%
Diamond	23	0.0076%	$149,942.00	$3,418,677.60	0.8%
Founders Emerald	56	0.0186%	$89,646.00	$5,002,246.80	1.2%
Emerald	137	0.0458%	$69,122.00	$9,497,362.80	2.3%
Q-12 Award	395	0.1317%	$39,763.00	$15,710,361.30	3.8%
Founders Platinum	811	0.2704%	$30,193.00	$24,492,561.60	5.9%
Platinum	1,273	0.4242%	$24,952.00	$31,753,915.20	7.7%
Total Pins	**2,715**	**0.9050%**	**$36,406.99**	**$98,844,794.10**	**23.9%**
Distributor Non-Pin Bonus	297,285	99.0950%	$1,060.11	$315,155,205.90	76.1%
Total Actives	**300,000**	**100%**	**$1,380.00**	**$414,000,000.00**	**100.0%**
Distributors Receiving No-Bonus	154,545		$0.00	$0.00	0.0%
All Non-Pins (99.4% of all Distributors)	**451,830**		**$697.51**	**$315,155,205.90**	**76.1%**
Total Distributors	454,545		$910.80	$414,000,000.00	100.0%

In a sample of 300,000 "Active" Quixtar Sales Representatives:

- ▲ There will be 454,000 total participants (Actives represent only 66% of the total participants)
- ▲ Approximately 155,000 will make no bonus at all (34%)
- ▲ 99.4% of the total earn on average just $13.41 per week -- before product purchases, all business expenses and taxes. This average income is far less than the costs of running the business. *This means that more than 99% make no profit.*
- ▲ In real numbers, approximately 452,000 out of 455,000 are in losing positions at the bottom of the chain. *In percentages this means 99.9% of all participants each year are the losers at the bottom. 50% of these people quit each year and are replaced by a new set of losing investors.*
- ▲ Upper levels that represent less than .6% of total participants (approx. 1 out of every 200) receive 24% of the total bonus payout. The mean average payout to this group is $700 per week, before product purchases, all business expenses and taxes. Since business costs are much higher for those at the top of the scheme, this means that, *even in this group, many make no profit.*
- ▲ Less than 1 person in 10,000 is at the "Diamond and above" levels.

 © 2005 Pyramid Scheme Alert

How the Quixtar Data Is Analyzed:

- A per-300,000-distributors base of analysis was needed because the number of people at the top is so small relative to the number of those below. A smaller sample could be used in other MLM studies, but with Quixtar a smaller sample would result in the use of *fractions* of individuals. Out of 300,000 distributors, for example, only two people are in the highest level.
- The use of the sample of 300,000 allows the data to be translated to figures that are more concrete and understandable.
- The percentages of distributors in each "pin level" (Platinum, Diamond, etc.) can be translated to actual numbers of people by applying them to a 300,000-person sample. For example, Quixtar revealed that 0.0007% of all "active" distributors are in the "Founders Exec. and Above" level. In a sample of 300,000, this means that just 2 people would be at that level. (The actual figure is 2.1).
- With the sample divided into actual numbers for each of the pin levels, and an average payment per distributor in each level disclosed by Quixtar, the total dollars paid to each level, per 300,000, can be calculated. The average payout per distributor in each level is multiplied by the total number in each level.
- The total payout to the non-pin levels is determined by subtracting the total payout to the pin levels from the total payout ($115 per month x 300,000) to the entire active group.
- With the total payout to each pin level and all those below the pins determined, the payout to each level as a percentage of the sum total payout is calculated by dividing the total of each level into the sum total payout.
- The number of "non-actives," i.e., those who received no commission payments, is based on the disclosure that 66% are "active". If 300,000 are "active" and that is 66% of the total involved, then 154,545 (34%) are "inactive" i.e., received no payments, for a total of 454,545.

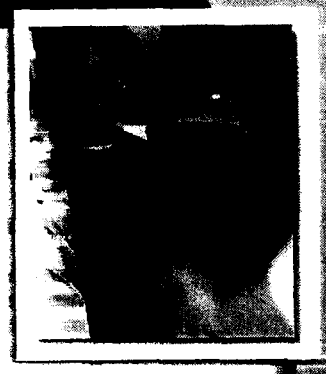
 © 2005 Pyramid Scheme Alert

Amway Data Disclosed on the Quixtar Website

***Note*: Quixtar refers to its distributors as "IBOs"**

DEVELOPMENT

QUIXTAR®



Average Annual Income for IBO's in North America*

2001 Average Annual Earnings in U.S. Dollars

- **Platinum $24,952**
- **Founders Platinum $30,193**
- **Q12 Award $39,763**
- **Emerald $69,122**
- **Founders Emerald $89,646**
- **Diamond $149,942**
- **Founders Diamond $227,400**
- **Exec. Diamond and Above $450,729**
- **Founders Exec. and Above $982,154**

The following are approximate percentages of Direct Fulfillment IBOs of record in North America who achieved these levels of success in the calendar year ending December 31, 2001. Platinum .4242%, Founders Platinum .2704%, Q-12 Qualifiers .1317%, Emeralds .0458%, Founders Emeralds .0186%, Diamonds .0076%, Founders Diamonds .0018%, EDC & Up .0042%, Founders Executive & up .0007%.

Based on an independent survey during 2001, "Active" means an IBO attempted to make a retail sale, or presented the Independent Business Ownership Plan, or received bonus money, or attended a company or IBO meeting in the year 2000.

Gross Income means the amount received from retail sales, minus the costs of goods sold, plus the amount of Performance Bonus retained. There may be significant business expenses, mostly discretionary that may be greater in relation to income the first years of operation.

The Average Monthly Gross Income for "Active" IBO's was $115

* Approximately 66% of all IBO's of record were found to be "active"

See additional information on the Welcome Page

© 2002 Quixtar Inc.

Appendix

I. How to Recognize – and Avoid – a MLM Recruiting Scheme

Five Red Flags

How does a consumer distinguish a "recruiting-MLM" in which more than 99% are destined to lose from a legitimate direct selling company in which income is based on retail selling? Dr. Jon Taylor, a Director of Pyramid Scheme Alert, has identified five telltale or "red flag" characteristics of the recruiting-MLM.

- ***Unlimited Recruiting*** ... In an endless and expanding chain, the opportunity for each new person to make money declines as the programs expand.
- ***Advancement by Recruitment...*** A participating "distributor" advances his/her position (and potential income) by recruiting other "distributors", who in turn advance by recruiting distributors under them. The only way a person can profit significantly in the scheme is through recruiting in order to advance to higher payout levels.
- ***Pay-to-Play...*** "Distributors" are encouraged to make significant purchases when recruited or are asked to sign up for continuing product purchases on auto-ship through an automatic bank draft, rather than making occasional purchases as needed. To remain qualified for commissions on purchases by downline the distributor must meet personal and group purchase quotas. Few make sufficient commissions to cover the cost of these expenses.
- ***Company commissions to more than five levels of "distributors"...*** The company pays overrides (commissions and bonuses) to distributors in a hierarchy of more levels than are functionally justified; i.e., more than five levels. Paying commissions and bonuses on more than five levels in an MLM program primarily enriches those at the top at the expense of those at the bottom.
- ***Company payout per sale for each upline participant equals or exceeds that for the person selling the product...*** A "distributor" purchasing products "for resale" receives about the same total payout (in commissions, bonuses, etc.) from the MLM company as participants several levels above who had nothing to do with the sale. The pay plan rewards recruiting over retailing.

While no one of these "red flags" by itself constitutes a pyramid scheme, taken together they create enormous leverage, enriching those at the top at the expense of a huge downline of unwitting victims of the scheme. These five characteristics define a pyramid scheme that is camouflaged as a "direct selling" company.

 © 2005 Pyramid Scheme Alert

Three More Tricks of Pyramid Perpetrators

- ***Tools and events*** ... Solicitations are made by the promoters for recruits to buy books and audiotapes or to attend costly training seminars, and "motivation events." Sometimes the main promoters make most of their money on these bogus "tools" and "events," not from the business they are soliciting consumers to join. They are literally in the recruitment, not sales, business.
- ***"Retail" sales projections...*** Income projections are based on sales at "full retail prices", for products that are frequently overpriced and not competitive in the marketplace. Nearly all products sold in a recruiting-MLM are purchased only by people signed up as distributors, not real consumers. The "retail prices" are fictional and misleading as are the projected retail profits.
- ***"Career" tracks...*** Promoters ask recruits to choose between two options or "tracks" – one for those who want to "retail" the products and another track for those who are serious about "building the business." If the incentives are heavily weighted towards recruiting, this is a moot question.

© 2005 Pyramid Scheme Alert

II. How to Prevent MLMs from Operating as Pyramid Schemes

The reports of thousands of consumers, state and federal prosecutions, media exposés, private lawsuits and class action suits against MLMs, and the record of massive losses to consumers who join MLMs, confirm the inherent trend of MLMs to become deceptive recruitment schemes. *Preventative* regulation is needed, not just after-the-fact law enforcement.

How can MLMs be prevented from operating as recruitment schemes rather than legitimate direct selling businesses? Two types of regulation are needed to assure that these types of companies do not become predatory recruitment scams, masquerading as "direct selling" businesses:

- Retail sales must be continuously audited.
- The MLM company must be required to fully disclose sales and income information to each new recruit.

Audited Retail Sales:

The level of retail sales levels has been used as the key factor for distinguishing retail-based from recruitment-based MLMs. But regulators only perform this analysis *after* a scheme is identified as a possible scam. Investigations and prosecutions take years and only occur after the harm is done.

The Federal Trade Commission should adopt and enforce a rule that all multi-level marketing companies provide audited verification of actual retail sales from all authorized distributors. At least 70% of such sales must be certified as made to persons outside of the distributors' downline networks and immediate families. Percentages of actual sales at retail prices should be documented and submitted for periodic independent audit.

- ▲ A 70% retail requirement level has been applied in various agreements between state Attorneys General offices and multi-level marketing companies charged with violating pyramid scheme statutes.
- ▲ A 70% retail requirement level assures that rebate payments to upline distributors are based upon actual consumer sales and not primarily upon recruitment of new distributors and are not, therefore, "recruitment fees."
- ▲ Reclassifying distributors as "end-users" and allowing wholesale purchases by other distributors" to count as "retail" sales are evasive devices regularly employed by pyramid marketers.
- ▲ Adoption of rules or policies regarding retail sales levels - without audited verification for each and every retail sale - is regularly employed as a deceptive maneuver by pyramid marketers. Internal reports by the multi-level marketing company are not acceptable, as such reports in the past have been falsified in a variety of ways. Reporting of compliance with such retail rules are suspect when distributors are warned that their distributorships could be cancelled if they do not state that they have complied.
- ▲ Rebates that are paid to upline distributors based on the volume of "purchases" by the downline -- with no verification provided for subsequent retail sales activity outside of the distributor network-- are actually recruitment fees, not commissions on "sales." This is especially true where sales are made at reduced wholesale prices in order to meet volume

 © 2005 Pyramid Scheme Alert