

Consumer Awareness Institute

# **The Case (for and) against Multi-level Marketing**

**By Jon M. Taylor, MBA, Ph.D.**

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### INTRODUCTION: purpose and plan for the book

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This book is intended to meet the need for a thorough analysis of the business model called multi-level marketing (MLM – a.k.a. “network marketing”) and its embodiment in the emergence of thousands of MLM programs (MLMs). Worldwide, thousands of consumers are approached daily with promises of income and independence from joining one of these MLMs.

#### The Amway precedent.



In 1979, Robert Pitofsky, acting as an administrative law judge for the FTC (Federal Trade Commission), ruled that Amway was “not a pyramid scheme.”

This ruling assumed Amway’s compliance with certain “retail rules” to assure that products were sold to the public and not just stockpiled. These rules were never significantly enforced.

MLM promoters cite the Amway precedent as justification for their programs, which have proliferated like a fast-growing cancer in the field of home-based business opportunities. Thousands of MLMs have come and gone since 1979, and hundreds remain - as viral and predatory as ever. Anyone reading the evidence with an

open mind will understand why I and other consumer advocates lament the Amway ruling - and failure to take remedial action since - as repudiation by FTC officials of the agency’s mission to protect consumers from “unfair and deceptive trade practices.”

This is an important topic because since 1979, hundreds of millions of MLM participants have in the aggregate been affected to the tune of hundreds of billions of dollars worldwide. And whether these participants were benefitted or victimized is a topic of hot debate between those who see MLM as a legitimate type of direct selling or home business opportunity - and those who see it as an inherently flawed and fraudulent business model, causing nearly all participants to suffer losses, only to enrich founders and those at or near the top of their respective pyramids of participants.

#### A much needed resource

This examination is long overdue. A survey of legal and business journals, Internet web sites, and a library of MLM promotional and training materials yields a mountain of opinions on both sides of a very contentious and ongoing debate about the legitimacy of MLM. But nothing approaching this level of analysis has ever been undertaken by a qualified independent research entity not underwritten by the MLM industry. I will bring together not only a brief sampling of opinions on both sides, but an assimilation of analytical thinking and independent research that should effectively answer a host of questions.

To illustrate the many facets of this topic, the list below is just a sample of the many questions that have arisen in my 15 years of research on this topic – and that will be addressed in this publication.

## The many questions to be answered in the book

- Is MLM a viable business model? Or is it seriously flawed - even a disguised pyramid scheme? How can MLM be clearly differentiated from other business models?
- What is the impact of MLM on individuals, families, and on society at large?
- How much money is gained or lost individually and in the aggregate?
- Are rewards proportional to effort; or do those who invest the most, lose the most? Should those who fail, blame themselves for not “working the system” - or blame the MLM?
- Can MLMs with their endless chain of recruitment continue indefinitely, or are they destined for saturation and ultimate collapse?
- Are MLMs profitable as business opportunities? And is a lifetime of “residual income” possible for all who work hard at MLM?
- Do MLM compensation plans reward part-time or seasonal participation with enough income to be worth their time and investment?
- Is MLM an honest business, or is it a system dependent on misrepresentations and unfair business practices?
- Are some MLMs legitimate, and others scams; and if so, how can one tell the difference?
- Can everyone profit from MLM? Is it just the founders and those at the top levels that reap most of the commissions and bonuses?
- Do most recruits merely join to get the products at a discount - as claimed by promoters?
- Are MLM products what promoters claim they are? Or are they overhyped and misrepresented?
- Does MLM cut out the middleman? Or are MLM products overpriced to pay off the many levels of distributors?



- Are prices of MLM products competitive enough to be sold at listed retail prices? Or do MLMs depend on purchases by participants for most of their sales revenues?
  - Is MLM ethical? Is ethical behavior of rewarded more than unethical behavior?
  - Do MLMs foster good relationships? Or does a person risk squandering one's social capital by participating in MLM?
  - Does MLM invite openness, or does it lead to more closed and cultish behavior?
  - Do endorsements by famous people and support of charities make MLM legitimate?
- Do “success tools” really benefit users, or do they primarily enrich upline sponsors?
- Does the DSA (Direct Selling Association), the MLM lobby, merely serve the interests of its members, or does it also seek to protect consumers from harmful programs?
- Do its chance elements qualify MLM as a form of gambling, or as a lottery?
- Are MLMs legal everywhere? If technically illegal in some states, why are they still operating?
- Where are consumer protection officials in all this? Do they have the skills, the resources, and the will to challenge fraudulent MLMs?
- What actions are needed to protect the public from “unfair and deceptive practices?”
- What actions can a victim take to recover losses from MLM participation?

While a resolution of these issues may seem a daunting task, I am confident that as this series unfolds, all who read with an open mind will be better able to answer these questions for themselves. Hopefully, readers will also be willing to share this information with others.

## MLM is an unfair and deceptive practice

Many look at MLM as a legitimate business model and attempt to single out individual programs as “bad actors.” However, in chapters 2 through 8, the reader will find compelling evidence for the unfairness of MLM as it is practiced throughout the industry.

Loss rates are extraordinary – over 99% for all of the MLMs for which I have been able to obtain relevant data. This in itself would not be so bad, except that it is promoted as an “income opportunity” – or even as a “business opportunity” – a misrepresentation in itself.

After reading these chapters, the reader may wonder if it is appropriate to refer to MLM, with its inherent flaws, as a “business” at all. Some who are familiar with MLM’s abysmal statistics feel it is more appropriate to refer to virtually any MLM as a scam.

**Loss rates are extraordinary – over 99% for all of the MLMs for which I have been able to obtain relevant data. This in itself would not be so bad, except that MLM is promoted as an “income opportunity” – or even as a “business opportunity” – a misrepresentation in itself.**

direct selling, after taxes and expenses, is positive. In addition, a positive net income is reported by nearly half of new direct sellers - those representing their current company for less than a year - and by nearly half of direct sellers who say that they are not very likely or not at all likely to continue in direct selling in the future.

**JMT:** She follows this with research<sup>2</sup> showing high rates of satisfaction for direct sellers. But the researchers fail to separate MLM from legitimate direct selling, but lumps them all

together. This makes MLM look better than it is. She continues:

This myth is also quite interesting because it essentially asserts that 15.2 million people in the US and 60 million people around the world continue as direct sellers despite losing money. Are we to believe the 5% of the US population would continue in a business where they are losing money? Simply put, most people do not lose money in direct selling.”

**JMT:** Anyone who reads Chapter 7 of this book or “*The Myth of ‘Income Opportunity’ in Multi-level Marketing,*” by Robert FitzPatrick will see just how blatantly false is this last statement.

## Sample MLM deceptions

Recently, on the web site “Direct Selling 411,” a representative of the Direct Selling Association (DSA), the lobbying organization for the MLM industry, published an article entitled “Top 10 Myths & Facts About Direct Selling,”<sup>1</sup> in which she supposedly states facts to counter what she claimed were ten myths a few of us consumer advocates have communicated over the web. Here is just a sampling of the counter arguments she gave to some of these “myths,” together with my brief response (**JMT**) to each:

**MYTH #1: 99.9% of direct sellers lose money; people are afraid to drop out for fear of looking like a failure.**

**FACT** (per DSA): More than half of direct sellers report that their net income from

**MYTH #2: Most direct selling companies are pyramid schemes that are doomed to fail.**

**FACT** (per DSA): There’s a big difference between legitimate direct selling companies and pyramid schemes. Pyramid schemes seek to make money from you (and quickly). Legitimate direct selling companies seek to make money with you as you build your business (and theirs) by selling real products and services. In fact, legitimate direct selling companies work hard to protect consumers from pyramid schemes.

**JMT:** She then touts the DSA Code of Ethics and suggests some questions a person should ask before joining a program.

<sup>1</sup> The web site was registered by Amy Robinson of the Direct Selling Association and is posted at the following web address: <http://www.directselling411.com/for-sellers/myths-facts/>

<sup>2</sup> 2002 National Salesforce Survey, Research International, Inc.)

Here she presents some good ideas that have merit, such as avoiding large startup costs in the beginning I applaud her for this. However, she does not address the usual MLM practice of bleeding people slowly with product subscriptions, web services, etc.

And the “big difference between legitimate direct selling companies and pyramid schemes.” Oh please. Again the implication here is that MLM is the same as legitimate direct selling. Anyone who reads Chapter 2 of this book will see that while this statement may be true for legitimate direct selling, MLM is a different animal. Rigorous comparative research on 350 MLMs shows that MLM and pyramid schemes represent a distinction without a difference – except that in MLM, products are offered. This does not mitigate the harm. Our research shows MLMs are the most harmful of the two classes of pyramid schemes (product and no-product), by any measure – loss rate, aggregate losses, number of victims, etc.

**MYTH #3:** Recruiting is the key to success in direct selling; sales to end-users of the products and services are minimal

FACT (per DSA): There's no doubt - recruiting is an important element of direct selling - just as expansion is important to any business that wants to grow. For direct sellers looking to build a business, recruiting others and mentoring them so they, too, can achieve their goals is important. But, recruiting is not a requirement for individual success in direct selling, and compensation must always be based on the sale of products and services - whether your own sales or the sales made by your recruits.

**JMT:** Read Chapters 2 and 5. The author has apparently not studied very many MLM compensation plans to see where the primary rewards are focused – on recruiting a huge downline or on retailing products. As psychologists learned decades ago, *you get the behavior you reward*.

**Built on an endless chain of recruitment, MLM is inherently flawed, deceptive, and profitable only for founders and those at or near the top of a pyramid of participants – usually those at the beginning of the chain of recruitment. MLM is also extremely viral and predatory.**

**MYTH #4:** The vast majority of new recruits quickly drop out.

FACT (per DSA): Nearly four in five (78%) direct sellers who are in direct selling for less than a year report that they are very or extremely likely to continue as a direct seller in the future. In addition, in a survey of former direct sellers, only 34% of them had a tenure in

direct selling of less than one year at the time they dropped out from direct selling.

**JMT:** MLMs scrupulously avoid publishing total attrition or retention rates. And again, the DSA fails to separate MLM from legitimate direct selling. Read Chapter 6 for a far more accurate picture on attrition rates than that presented by the DSA.

**MYTH #5:** Direct selling is an outdated method of buying and selling.

FACT (per DSA): More and more people are getting involved in direct selling because they enjoy the personal service that accompanies shopping this way. In fact, direct sales have increased 79% in just over a decade from \$17.94 billion in 1995 to \$32.18 billion in 2006.

**JMT:** Read Chapters 2, 7, and 8. These sales figures the DSA brag about represent losses for the vast majority of MLM participants. These are numbers that should cause the DSA to hang their heads in shame because, at least for MLMs, such sales represent losses for participants who were deceived into thinking they were buying a “business opportunity.” The ones who benefit are founders, executives, and TOPPs (top-of-the-pyramid promoters). From their own reports, we learn that 99% of MLM participants lose money.

**MYTH #6:** Direct selling products are overpriced

FACT (per DSA): The consumer market won't sustain products that are overpriced for long. Competition is a powerful force and products that aren't competitively priced won't sell and can't last.

But for direct selling, there's a bit more to the price equation than might immediately meet the eye. The decision to sell a product through direct selling is often based on very

specific factors. For example, products that require demonstration to convey the finer points of their operation are ideal for direct selling because a knowledgeable salesperson can personally conduct that demonstration for every customer. In a traditional retail setting, consumers might not understand the product's unique qualities based on appearance or packaging. It's true that some direct selling products are priced at the upper end of the retail market's acceptance level, but there is higher acceptance based on the value-added incentive of the demonstration and personal service. Lexus brand cars are also at the upper end of the retail market acceptance level, but superior performance and service after the sale make that higher price reasonable. Each customer needs to weigh the price, quality and desirability of a given product and make a purchasing decision accordingly.

**JMT:** There is some merit to these arguments. But \$88 (including shipping) for a month's supply of vitamins for one person - or \$320 for a family of four? A bottle of fruit juice for \$50, and a case for \$300? And a set of cookware priced from \$4,000 to \$10,000? Come on. Please read Chapter 4.

I won't bother to comment here on the rest of the "myths" the DSA lady attempts to debunk. But here they are:

MYTH #7: Direct selling companies are unregulated

MYTH #8: Most companies require inventory purchasers; direct sellers who drop out are stuck with the inventory they purchased

MYTH #9: If you attend a direct selling party you are expected to buy something

MYTH #10: Everyone who gets involved in direct selling wants an easy way to make money

**JMT:** In Chapter 8 the reader will find a list of over 100 misrepresentation typically used in MLM recruitment campaigns, paired with my debunking of each of these deceptive claims. These deceptions are also used to persuade some participants to continue spending on a program that can become a major money trap for them.

## The title and logical bias of the book

The reader may wonder why the strange punctuation of the title of this book: "*The Case (for and) against Multi-level Marketing.*" The parentheses suggests that although arguments will be presented both for and against MLM, it will be clear from the first chapter that arguments favoring MLM will not be emphasized, but will be debunked. This is because MLM as a business model is *fundamentally* flawed, uneconomic, and deceptive, predicated as it is on an endless chain of recruitment, as are "pay to play" chain letters and no-product pyramid schemes.

MLM assumes both infinite and virgin markets, neither of which exists in the real world. The evidence from independent research and analysis will clearly support these conclusions. And in addition, worldwide feedback strongly suggests that MLM is also extremely viral and predatory.

The FTC considers naked, no-product pyramid schemes as illegal per se as an unfair and deceptive practice. As Bruce Craig, former assistant to the

Attorney General of Wisconsin wrote: "The premise of 'multi-level vs. pyramid' marketing may well represent a distinction without a difference."<sup>3</sup> The addition of products may merely serve to disguise or launder the investment in a pyramid scheme.

*This is not merely author bias.* Looked at objectively, any independent analyst with basic understanding of markets and statistics who would consider this issue objectively would agree with this conclusion. So I make no attempt to present the entire catechism of deceptive arguments used by MLM defenders. Thus the parenthesis.

**MLM assumes both infinite and virgin markets, neither of which exists in the real world.**

<sup>3</sup> Letter dated February 25, 2000, from Bruce Craig to Robert Pitofsky, Chairman of the FTC – and the official who drafted the Commission's Amway opinion in 1979

## Plan for the book

This information was originally published as an e-book, drawing from the extensive research and writing I and other independent analysts have done, while inviting additional comments from readers as the project continued. The book can be downloaded chapter by chapter from my web site – [www.mlm-thetruth.com](http://www.mlm-thetruth.com).

Additional input from other independent consumer advocates, regulators, attorneys and academicians has been utilized. Where appropriate, MLM officials and advocates have been incorporated, even though their arguments for MLM may seem deceptive or convoluted.

In making decisions on which research and comments to include in the book, I assume full responsibility. However, I am confident that – based on extensive training, research and experience (see Chapter 1) – this book will be the most reliable source of information available on the viability, profitability, and ethics of MLM as a business model; on the consequent unfair and deceptive practices in the industry as they affect consumers; and on ways to protect consumers from the worst abuses.

Finally, *The Case (for and) against Multi-level Marketing* is not strictly a book of legal evidence and arguments on MLM. Though I have consulted with many attorneys and officials in law enforcement on the legal issues, I am not an attorney. I am writing on this issue from the perspective of a qualified salesman, entrepreneur, business analyst, and consumer advocate. And the issue of consumer harm – which this book addresses in depth – has relevance both for consumer protection and for legal or regulatory actions. It is my hope that the book will serve as an invaluable tool for consumer advocates, law enforcement officials, educators, media reporters, and seekers of legitimate home income opportunities. It should also be helpful as a primary reference guide for plaintiff attorneys representing MLM victims.

**Please read this book carefully, then pass it on to someone else (or better yet – send to your entire email list the link for downloading it and suggest that they do the same). Then ask that they each encourage those they contacted to do the same for their contacts. You can help initiate an endless chain of truth-telling to counter the deceptions passed along by the chain of unwitting MLM participants.**

## *The Case (for and) against Multi-level Marketing*

By Jon M. Taylor, MBA, Ph.D.

### **Chapter 1: MLM UNDER MY MICROSCOPE – why and how the research upon which this book is based was undertaken, and why the author can speak with authority on the subject**



#### **Chapter contents**

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- Communications with top executives and communicators of leading MLMs
- Strong grounding in ethical principles, including authorship on MLM ethics
- Extensive writings on MLM quoted by attorneys, legislators, and the media
- Presentations to regulators at nation-wide conferences on MLM
- Promotion of legislation and rulings to protect against MLM fraud.
- Consultant and expert witness in many legal cases regarding MLM abuses

#### **My background & qualifications**

**Important qualifications for an authority on MLM.** If a top consultant were needed to sort out complex issues related to the legitimacy of MLM, what would his ideal set of qualifications look like, including education and both life and career experiences? I think the following list, which is what I bring to the task, answers that need. This is not to boast – just a summary of my background as it applies to this topic:

- Expertise in business analytical skills – ideally an MBA degree
- Doctoral level research, training, and experience evaluating others' research
- Many years of experience in direct selling and in sales management
- A wide range of entrepreneurial and home-based ventures
- Direct experience in a leading MLM and success in building a downline
- Experience analyzing hundreds of MLMs, using a well-researched and consistent analytical model
- Compilation of the experience of thousands of participants in a wide range of MLM programs

My whole career led to my expertise and consumer advocacy in this arena. Some may ask what qualifies me to do this research and to pull all this material together in an authoritative report. That's a fair question and deserves an answer. Though the following



sketch of my background is lengthy, it should forever put to rest the uninformed opinions of some critics that Jon Taylor "doesn't have a clue what MLM is all about."

As a young man, the last thing I would have imagined was my stepping forth as a leading authority on multi-level marketing. But fate – or an overruling providence – seems to have pointed me in that direction from my early years as a wide-eyed seeker of what the career world had to offer. It is as though my whole life was somehow pointed toward this advocacy on behalf of consumers and regulators struggling with the exploding phenomenon of multi-level marketing, or the commonly accepted acronym "MLM."

**Analytical skills and a solid background in sales, entrepreneurship, and ethics.** I graduated in education and taught religion at the secondary level for two years before returning to Brigham Young University to complete a full-time MBA program at Brigham Young University, requiring two years of coursework in economics, statistics, finance, accounting, and the analytical skills essential for business success. From this training, I gained the skills needed to analyze business options and to assess their profitability and viability.

I also pursued research on entrepreneurship and led a group project surveying corporate executives on “Sales as a Career Option for College Graduates.” This was at a time when both sales and entrepreneurship were not yet considered respectable topics in academia.

In subsequent years, as an adjunct instructor at four different universities, I taught personal finance, entrepreneurship, business ethics, communications, and management – all of which came in handy later as a consumer advocate, communicating about complex MLM issues. I refined and taught skills needed for successful entrepreneurship and sales programs, as well as ethical business practices.

Coincidentally, I founded the non-profit Consumer Awareness Institute to conduct research and teach seminars



related to personal finance and entrepreneurship – and wrote several articles that were published by various consumer and entrepreneurship magazines. I’ve also published several consumer guides, some for the distribution through group and commercial channels and some for Internet consumption. For each project – on an ad hoc basis as needed – I consult other experts in the field or hire help – usually college students.

**Home income opportunities galore.** In the late 70’s, as a young widower, I was determined to find ways to support my two children without leaving home. This led to extensive research on the whole field of home-based business opportunities. I read all I could on the topic and undertook research for a planned national Income Opportunity Directory. The project outgrew me, as I uncovered thousands of income options. But I learned of the vast opportunities available outside the standard job market.

I sponsored a trade show called “The Income Opportunity Show,” to showcase income or business opportunities, many of which could be operated from home. Interestingly, MLM promoters scrambled more aggressively than any of the other companies for the best booth locations.

**Serial entrepreneur for sure.** Because of my creative inclinations and familiarity with the vast array of self-employment options, I started one business after another as a “serial entrepreneur.” I didn’t enjoy managing them, just creating them from scratch – often a business concept that had never been tried before. For those ventures that failed to show positive results, I learned to cut bait early and not continue throwing good money after bad. I would shut it down and begin again with another concept for a venture waiting in the wings.

Conversely, as soon as a business began to show significant profits, I sold out and went on to create another venture. As expected, some failed, and others succeeded; but in the process I learned some valuable lessons on what is required to start and build a successful home business. With careful research and good marketing, about half of these ventures produced profits within the first few months.

Also, because my funds were limited, all these business startups were bootstrap operations, requiring little capital. Such ventures nearly always required much salesmanship, so I honed my sales and marketing skills and trained others in the skills needed to promote new ventures. I know what legitimate selling entails.

Over a period of 30 years, I founded or consulted in the founding of over 40 home-based businesses. These included

an educational game simulation company, an advertising and public relations agency, a training video preview service, a national motor home rental referral agency, pre-need funeral sales programs, radio transmission for high school driver education, publishing ventures, numerous trade shows, several traveling seminars, centralized seminars transmitted by satellite, a nationwide nanny screening and referral agency, and research-based resume and self-marketing programs. One could say I was a bootstrap, serial entrepreneur!

**Direct selling experience.** Along the way, I often engaged in direct selling, which proved to be the most profitable of the many businesses in which I participated. I paid much of my college expenses selling encyclopedias, and I won many salesmanship awards when I sold insurance and pre-arranged funeral plans. *I do know the difference between legitimate direct selling and pyramid or chain selling.*

**“Residual income” – and legitimacy.** I provided consultation for mid-career changers, many of whom were seeking my guidance in pursuing small business or self-employment options. Also, from authoring books and from promoting health insurance and other programs for small businesses, I experienced the luxury of “residual income” – frequently cited by MLM promoters as the inevitable result of building a downline of distributors (or so they claim).

I was careful to assure that all of these ventures were organized and operated using the strictest of legal and ethical standards. Based on my MBA training, all this experience, and the ethical principles I have always held and taught, I was in a strong position to discern between businesses that were legitimate and those that were not.

**Doctoral studies, research, and teaching.** Midlife in my varied career, I completed doctoral studies in Applied Psychology at the University of Utah. This gave me research skills that were extremely helpful in my consulting, in teaching adult

education classes and private seminars, and in my independent research on many topics, including MLM. Also, for a brief period, I worked on the administrative staff of both Brigham Young University and the University of Utah, evaluating the research of others.

**First-hand experience with MLM – “Been there, done that.”** I had been aggressively recruited many times by various MLM participants and witnessed firsthand their powerful motivation to recruit, using dubious and deceptive recruiting methods. But having taught college classes in finance, entrepreneurship, and ethics, and having been a successful salesman and entrepreneur, I was skeptical of recruitment-driven schemes labeled as “network marketing” or “MLM.”

However, under pressure from respected friends to join various MLM programs in 1994, I considered doing a do a one-year test of an MLM that my research led me to believe was one of the best of the MLMs I could join – Nu Skin. I wanted to prove to myself and to others whether or not MLM was a legitimate business model. Those who recruited me claimed that with my capabilities and contacts, I could rise to the top level of “Blue Diamond” within two years - and that those at this exalted level averaged earnings of over \$750,000 a year.

I told myself that if that were true, I could live on that. But if it proved to be just a money trap or disguised pyramid scheme, as I suspected, I would tell the world about it.

Prudence dictated that before finally joining, I do some “due diligence” by reading on MLM and by checking out Nu Skin and other

MLMs with the Consumer Protection Division at Utah’s Department of Commerce, as well as with the Better Business Bureau, which had received few complaints against Nu Skin. Both gave out literature that was favorable to



**\$750,000 per year! I told myself that if that were true, I could live on that. But if it proved to be just a disguised pyramid scheme, as I suspected, I would tell the world about it.**



MLM, assuming the company was financially solid and that legitimate products were offered.

I later learned that at least one of the pieces of literature handed out was supplied by the Direct Selling Education Foundation, sponsored by the Direct Selling Association (DSA), which lobbies for the MLM industry. But at the time, it seemed credible.

Finally convinced, I dragged my suspicious wife JoAnn out to a couple of Nu Skin opportunity meetings. The pep rally atmosphere was a big turn-off for her. She concluded, "I have a bad feeling about this."

But I persisted, and she reluctantly gave in to my promise to try it for a year - and then re-evaluate the program. This was OK with me because in all my previous ventures I could assess the potential profitability of a business within the first few months.

**"I drank the Kool-aid."** My decision was to give total dedication to the program for at least a year, as it would not be a valid test otherwise. Even with my extensive background in math, entrepreneurship, and sales, I "drank the Kool-aid" and eventually bought into the whole MLM mentality.

Looking back, I am ashamed for having overlooked MLM's mathematical trick – the promise of an unlimited income from an endless chain of recruitment. This was "cognitive dissonance" personified. I became a believer.

I did everything my company and upline recommended – subscribed to and tried a wide range of their products, recruited people I knew, sought any referrals I could get, advertised after exhausting my "warm market" of friends and family, attended all the training and opportunity meetings (conducting some myself), and used my best efforts to train and motivate my recruits.

I tried selling Nu Skin's nutritionals, but they were expensive, even at wholesale. To satisfy qualifications for commissions as an "executive distributor," I purchased products to give out as samples to any potential prospects – and hyper-consumed them myself.

It soon became apparent that to get to a level where the money was made, I would have to continue my aggressive recruitment campaign, luring prospects of the Nu Skin "business opportunity" to buy a "business in a box," which consisted mostly of an expensive package of products to become a "business builder."

As recommended, I bought five of these packages (for about \$1,600) to jump-start five new recruits, which not only helped me to advance in the distributor hierarchy through their "fast start" program, but also gave me a powerful incentive to recruit to recoup my investment. Fortunately, as a researcher I kept detailed notes of my experiences and records of expenses while recruiting for Nu Skin.

**"Wanna play?"** While introducing new recruits to Nu Skin, I often asked them to attend "opportunity meetings" at which a high level distributor would give a presentation touting the benefits of Nu Skin and of what was then referred to as "network marketing."

One of these speakers presented Nu Skin as a game. Just like any game, the person has to be willing to enter the game to gain any fun from participating. He pointed out that the "winners" in this game would be handsomely rewarded – as much as \$750,000 a year, which was what Blue Diamonds were then averaging.

At the close of his presentation, he would challenge us to "play the game" of the Nu Skin version of network marketing. His question "Wanta play?" was intended to get us to sign up right then. He said you never know how a person you recruit might catch fire and make you rich from the downline he might build, from which you could draw commissions. In retrospect, this appeal to chance is grounds for the application of lottery statutes to MLM in some states. (See Chapters 2 and 10.)

**The 3-foot rule.** I became a serious player of this network marketing game. I read everything I could on the subject, followed suggestions of my upline to the letter, and recruited aggressively. I consistently applied the "3-foot rule" – everyone within three feet of me was a prospect.



**“It’s Nu Skin or me – take your pick.”**

My wife began asking questions after a few months of pitifully small commissions, even though I had risen to a level of the top 1% of distributors – assuming all recruits were counted. She did not like the changes that were occurring in me and in our relationships with treasured friends and family members, whom I was attempting to recruit.

Finally, at the end of a year, JoAnn threatened to leave me if I continued, as it was changing for the worse the man she married. *“It’s Nu Skin or me – take your pick,”* she warned. Where I had ignored my wife’s negative impressions when I first joined Nu Skin, now her ultimatum caused me to take a closer look at my participation – and at our finances.

**“It’s Nu Skin or me – take your pick,” she warned.**

**Ethical conflicts.** As a former teacher of ethics and one who considers himself an honest man, one facet of MLM fascinated me even more than the money. In re-examining my participation in MLM, I discovered a whole range of ethical conflicts that for me made MLM an unacceptable way of conducting a business.

In fact, before I quit Nu Skin after about a year of concentrated effort, I could see clearly what I would have to do to earn the huge commission checks that were held out to new recruits. I decided it was simply not worth it. Why? Because I would have to recruit by convincing prospects (like I had been deceived) into believing they too could achieve what I claimed to have achieved – or was on the road to achieving.

For me to receive the income that was held up as possible, thousands (in such a highly leveraged program) would have to lose their investment. After all, the money would have to come from somewhere. In

**For me to receive that level of income, thousands would have to lose their investment. The money would have to come from somewhere. Also, I would have to continue to insist that MLMs were not illegal pyramid schemes, but legitimate direct selling programs.**

MLM, it would come from purchases of downline distributors, since few products were sold to non-distributors. Also, I would have to continue to insist that MLM programs like Nu Skin were not illegal pyramid schemes, but legitimate direct selling programs.

**Top 1% and losing over \$1,200 a month.** Though I had become successful at recruiting and climbing the ladder of distributors (again, in the top 1% if all distributors were counted), I was still losing over \$1,200 a month, after accounting for all expenses, including purchases required to maintain qualification for the “Executive” level in the compensation plan – which was necessary to have any hope of profiting after expenses.

**Top 1% of distributors, but losing \$1,200/month – NOT what I signed up for!**

It soon became apparent that to earn the huge income that was promised, I would have to be at or near the top of a huge pyramid of participants, which I believed was possible. But after carefully considering my situation and coming to recognize the foolishness I had fallen into, I quit Nu Skin and decided to tell the world what I had learned – not just about Nu Skin, but about the entire field of MLM (a.k.a., “network marketing”), about which I had undertaken an intensive research overview.

## **I go public and initiate some serious research**

**I publish the story of my experience and lessons learned from MLM.** After conducting surveys to determine the amount of MLM activity in my state and a cross section of citizens’ opinions about it, I wrote a book titled *The Network Marketing*

*Game*, which exposed the ethical problems of exploiting friends and family for personal gain. While on a speaking tour promoting the book, I got feedback from tax accountants who asked why – with all the MLM promoters’ promises of “residual income” – they were not seeing profits reported on tax returns of MLM participants.

**The tax man knows.** I decided to interview tax professionals in several counties – totaling almost 300 of them over a period of several years. This included interviews with programmers of tax software and persons involved in seminars for tax professionals. With a total of over two million tax returns represented nationwide, a clear picture emerged of who was making - and who was losing - money in MLM. The results were startling. Finally, in 2004, this research was published in a report published on my web site entitled *Who Profits from Multi-Level Marketing? Preparers of Utah Tax Returns Have the Answer.*



**From MLM recruiter to consumer advocate.** In 1998, I mailed my initial conclusions to the presidents of 60 of the most prominent MLM companies, asking them to provide specific data to "prove me wrong." To this day, this challenge remains unmet. It was published on my web site as *Network Marketing Payout Distributions Study*. I also published *MLM or Network Marketing — the Ultimate Pyramid Scheme*, *12 Tests for Evaluating a Network Marketing “Opportunity”*, and *Product-based Pyramid Schemes: When Should an MLM or Network Marketing Program Be Considered an Illegal Pyramid Scheme?* All of these created quite a stir when posted on the internet.

**Why all this detail on my background?** My reasons for recounting all of the above is to answer the common charge of critics that “Jon Taylor hasn't a clue of what MLM is about” – or that I have “no real world experience in how to sell or to manage a business.” The foregoing should put all such blind assertions to rest. At least,

it answers all the qualifications for an ideal expert for this project as outlined above.

Other MLM promoters charge that my experience with MLM was with a "bad MLM" - Nu Skin. Their typical comment goes something like this. "But - our MLM is different. Everyone can make money at THIS MLM," or "We have the most powerful compensation plan in the industry," or "We're not really MLM, we sign up referral customers," etc., etc.

My response is that after analyzing the compensation plans of hundreds of MLMs and the average income for those that have released such data, it is now possible for me to make reliable generalizations about MLMs (i.e., multi-level or network marketing, entrepreneurial chains, product-based pyramid schemes - or whatever you choose to call them) – as a business model that applies to all MLMs. And I have yet to find any exceptions to these generalizations, in spite of 15 years of research and worldwide feedback.

*This is not to boast, just a statement of fact: I DO know what I am talking about - if anyone does. And I DO have the background to test and evaluate MLM as a business model, as well as specific MLM programs - if anyone does.*

#### **Sour grapes - or moral imperative?**

Other critics see my analysis of the MLM industry as merely the 'sour grapes' attitude of a disgruntled ex-distributor who failed at MLM. I can only respond that I was successful at becoming one of the company's top 1% in the hierarchy of distributors - only a small percentage of ALL recruits (Nu Skin doesn't count dropouts) reach even “Executive” level.

However, such success was not reflected in any profits, but instead in substantial losses, after all purchases and operating expenses were subtracted, to say nothing of \$50,000-\$100,000 lost from not working at a profitable sales-oriented business during that year. Also, I was fulfilling my initial pledge to myself to make public what my experiment with MLM taught me, and I feel a moral imperative to help others avoid the pitfalls inherent in this "industry."

Shortly after I began posting my findings to educate and warn consumers against MLMs like Nu Skin, one of Nu Skin's communicators released a statement about me and my motives in going after Nu Skin to anyone who would inquire. For Nu Skin's criticisms and my rebuttals to each, read "*Nu Skin Attempts to Discredit it's Whistleblower*" (Appendix 1A)

**This is not to boast, just a statement of fact: I DO know what I am talking about – if anyone does. And I DO have the background to test and evaluate MLM as a business model, as well as specific MLM programs – if anyone does.**

companies. However, the most gratifying rewards from all this research have been the thousands of emails and responses to my web site from persons all over the world who express their thanks for saving them from potential losses.<sup>6</sup>

I financed all this research myself and did not profit from it, except for legal cases for which I was hired as a consultant and expert witness. However, for the first few years this did not begin to cover my time and expenses.

## **I share my findings with consumers, regulators, attorneys, and consumer advocates.**

To reach out to a broader audience of consumers, I initiated a website and cooperated with other consumer advocates and top experts who were reporting their findings and experiences with MLM. These included Robert FitzPatrick<sup>4</sup>, President of Pyramid Scheme Alert; Bruce Craig, former assistant Attorney General in Wisconsin; Kristine Lanning, (former) Assistant Attorney General of North Carolina; Doug Brooks<sup>5</sup>, plaintiff attorney dealing with MLM cases; and Susanna Perkins, author and sponsor of mlmsurvivor.com.

With the cooperation of these extremely knowledgeable and capable experts, and acting as a Director of Pyramid Scheme Alert (with Robert FitzPatrick as President), I organized seminars on product-based pyramid schemes for state and federal regulators in Washington, D.C., and at the National White Collar Crime Center in Richmond, Virginia. I also cooperated with sponsors of other web sites offering useful information on MLM.

My research was also presented at other national and state anti-fraud conferences, including the Economic Crime Summit Conference in 2002 and 2004. Robert FitzPatrick and I have been called upon as expert witnesses in several legal cases against MLM

**Finally – recruitment-driven MLMs, or product-based pyramid schemes defined.** I spent months analyzing features of MLM and classic pyramid schemes and comparing them with features of legitimate direct selling and other home businesses. With my extensive background in sales and entrepreneurship, I was able to make some clear distinctions missed by other analysts.

In fact, I had not only done direct selling (which MLM adherents claim to be doing), but had recruited, hired, and trained sales persons and telemarketers. I knew what characterized legitimate direct selling – and even legitimate recruiting. After months of comparative analysis and discussions with top experts, five “red flags” or characteristics became apparent that clearly distinguished chain or pyramid selling schemes from legitimate direct selling business-es. The first four applied to all MLMs, the fifth to most.

These features, which could be identified in MLM's compensation plans, resulted in extremely high loss rates and helped to identify MLM's that were in violation of laws in most states, as well as FTC guidelines. In fact, wherever I could get the earnings reports of participants in MLM's with these “5 Red Flags” in their pay plan, approximately 99.6% of ALL participants (including dropouts) lost money, after subtracting ALL expenses. In fact, with

<sup>4</sup>Sponsor of pyramidschemealert.org

<sup>5</sup>With Martland and Brooks, LLP, Boston, Mass.

<sup>6</sup> See sample feedback in Chapter 9.

a more strict interpretation of the data, the loss rate is closer to 99.9%.<sup>7</sup>

These expenses included minimal operating expenses and “incentivized purchases” (necessary to qualify for commissions or bonuses) of goods and services from the company.<sup>8</sup> MLMs even make obviously illegal no-product pyramid schemes look profitable in comparison.

**The “5 Red Flags.”** These five red flags were then presented in the form of a “5-step do-it-yourself MLM Evaluation” quiz. It soon caught hold, and thousands of MLM prospects have used it to keep themselves out of MLMs that could have caused considerable financial loss.

I also published and presented *THE 5 RED FLAGS: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM's* at the 2002 and 2004 Economic Crime Summit Conference, co-sponsored by the National White Collar Crime Center.



Over the past several years, I have used this “5 Red Flags”<sup>9</sup> model to analyze the compensation plans of over 350 MLMs – and correlated them with average income data of participants (where such data was available). All of this has enabled me to make generic observations of consistent structures and practices of MLM as an industry – and losses suffered by participants – that would not have been possible any other way. These observations and the research underlying them will be explained in subsequent chapters.

**Craps or MLM?** The numbers don't lie. Other critics see me as biased against MLM in my research and reporting. This can be answered with a gambling analogy to explain my position. If the owner of a gambling casino in Las Vegas were to post a “Business Opportunity” sign at his craps or Roulette tables, the Nevada gaming authorities would

take action against him. And no one would argue that a writer covering the issue should be impartial in reporting on whether or not gambling is a legitimate business opportunity. It is gambling.

In fact, I called Las Vegas gambling casinos and learned that the odds of profiting from craps or Roulette are far better than the likelihood of profiting from a typical MLM. Please don't misunderstand me. I am not promoting gambling; I never gamble. But I am all for honest and ethical business practices in any endeavor. At least gambling casinos are honest enough not to claim that those who play at their gaming tables are investing in a “business opportunity.”



**One can do better in Las Vegas – than in MLM!**

**MLM is not the only game in town.**

From feedback all over the world it became apparent that many people are drawn into MLM because they are unaware of the many self-employment alternatives open to them. So using my past research and experience, I wrote the report *1,357 Ways to Make More Money than in MLM*. This report, along with suggestions for success-ful self-employment and links to websites that provide additional information and point to helpful resources, is posted on my website.

<sup>7</sup> See Chapter 7.

<sup>8</sup> See Chapters 5 and 7

<sup>9</sup> There are really 5 causative and defining characteristics and a fifth in most, but not all, MLMs.

## Legislators and regulators yield to DSA/MLM lobbying, creating a vacuum in consumer protection.

Utah and other states duped by DSA. In 2006, the DSA and local MLM companies lobbied intensely for a bill weakening Utah's Pyramid Scheme Act. I testified at hearings on behalf of consumers who were being victimized by what I dubbed "product-based pyramid schemes," or MLMs. But with well-placed political donations and the implication of a powerful voting block of MLM participants, the bill was passed in 2006, exempting MLMs with consumable products from prosecution as pyramid schemes. Even the Attorney General testified in favor of the bill, but without disclosing that MLMs were his chief political donors. Several other states have been similarly affected by DSA-initiated legislation.



In 2006, the FTC proposed a Business Opportunity Rule that would require sellers of business opportunities to disclose average incomes, references, and other information crucial to a decision on whether or not to participate. Comments were invited, and the DSA and its members issued appeals to millions of MLM participants to use their form letters to write in objections to including MLM in the Rule. Some 17,000 offered comments following their suggested form letters. I wrote comments rebutting the comments of participants and spokespersons for over 30 MLMs.

Also, the DSA influenced 86 Congressmen to object to including MLM in the Rule. The FTC gave in to the pressure, and in 2008 a Revised Rule was proposed, exempting MLM. Commenting for consumers, I objected to this exemption with additional comments, and in 2009 participated in a workshop at the FTC offices on the proposed final version of the



Rule – again objecting to the FTC's exemption of MLM from having to provide transparency needed to protect consumers from unfair and deceptive practices, which protection is a core mission of the FTC.

## My resolve to do something for consumers

**Something to get passionate about.** Knowing my grasshopper approach to career decisions in the past, hopping from one startup business to another, friends have asked me what has driven me to stay with my consumer advocacy, focusing so intently on this one business model for 15 years.

My answer is that when I discovered how deceptive, unfair, viral, and predatory this industry is, and how few people – including regulators – understand the consequences of MLM participation, both individually and in the aggregate, it seemed right to stand up and use my unique background and skills to challenge the industry and to provide guidance to prevent consumers from being victimized by fraudulent schemes. It is both the outrage I feel at the unchecked growth of this unfair and deceptive practice, as well as letters of deep appreciation from persons around the world who used my information to remain solvent by refusing MLM recruiters, that keeps me going.

**I go where the facts take me.** The abysmal average income statistics for new MLM recruits only confirms the inherent flaws in MLM as a business model, depending as it does on the recruitment of an endless chain of participants as primary customers. MLM is built on the same endless chain concept as the clearly illegal chain letters of the past, where each person sends \$5 to all the persons on a list and is asked to add his name at the end and forward it on to all his/her friends, asking them to do the same. So I have no hesitation in gathering the evidence and arguments on both sides and then showing the flaws in the arguments put forth in favor of MLM as a legitimate "business opportunity."

## Appendix 1A: Nu Skin attempts to discredit it's whistleblower

### Nu Skin's response to inquiries about Dr. Jon Taylor, the whistleblower – and Taylor's rebuttal.

<p><b>Statement by Nu Skin in response to inquiries about Jon Taylor, the primary whistleblower for Nu Skin Enterprises, Inc.</b></p>	<p><b>Rebuttal by Jon Taylor, including references for further information.</b> ("MLM" is the acronym for multi-level marketing, or network marketing. "Recruiting MLM's" are MLM companies that reward recruiting far more than selling to non-network customers. )</p>
<p>NOTE: Unable to refute Taylor's charges that Nu Skin continued its misrepresentations since the 1994 FTC Order for NS to stop misrepresenting earnings of its distributors, NS officials attempted to discredit the company's primary whistleblower. Comments from an official company statement follows ( <i>in italics, ed.</i>) in this column: <i>Nu Skin believes that Dr. Taylor fails to make the distinction between legitimate network marketing and illegal pyramid schemes.</i></p>	<p><b>I performed extensive comparative analyses of alternate business models to which MLM is often compared, and found five defining characteristics which clearly distinguish legitimate business operations from recruiting MLM's, or product-based pyramid schemes. Please read carefully my report entitled <i>The 5 Red Flags: Five Causal and Defining Characteristics of Product-Based Pyramid Schemes, or Recruiting MLM's.</i> A more valid and thorough analysis of such distinctions has not been done elsewhere, certainly not by Nu Skin or the DSA (Direct Selling Assn.), the public relations and lobbying arm for the MLM industry.</b></p>
<p><i>Contrary to Dr. Taylor's statements, credible network marketing companies are committed to protecting consumers, not preying on them.</i></p>	<p><b>While most participants in a recruiting MLM's do not see themselves as victimizing or "preying" on those they recruit, a careful reading of my reports on product-based pyramid schemes should help in assessing their extensive harm to consumers. Based on available data, the five defining characteristics result in an approximate loss rate of 99.9% (at least 99.94% for Nu Skin).</b></p>
<p><i>Nu Skin charges a low sign-up fee, requires no initial purchase of product,</i></p>	<p><b>The sign-up fee is irrelevant. It is the "pay to play" or incentivized purchases that constitute disguised pyramid investments and the aggregate losses of billions of dollars to millions of unsuspecting consumers. NS promoters sell "pay to play" purchases aggressively.</b></p>
<p><i>will refund 90% of the cost of unused product returned within a year,</i></p>	<p><b>Few understand within a year that they have been scammed without deprogramming. It took me several years of donated research to fully decipher all the deceptions - even with an MBA, a Ph.D., and over 30 years marketing and direct selling experience.</b></p>
<p><i>and is a NYSE-listed publicly traded and audited company.</i></p>	<p><b>Responsible SEC and the NYSE officials would be concerned if they understood that a highly leveraged pyramid scheme was listed and sold to investors under the guise of a direct selling company. And after Enron, Worldcom, and Arthur Anderson, does anyone seriously believe that a company's reports are automatically to be trusted just because they have been audited using "GAAP" - generally accepted accounting principles?</b></p>

<p><i>The company is a responsible corporate citizen that employs thousands of people from every walk of life and shares its resources generously in every market where it does business.</i></p>	<p><b>That they do - and by so doing buy credibility among unwitting consumers and government officials. If organized crime organizes soup kitchens in ghettos or the Columbian drug cartel assists cocaine farmers, does that make them legitimate? The fact that NS "employs thousands" should not obscure the source of the money used to do so. Do the ends (employment and charity) justify the means (defrauding millions of unsuspecting consumers worldwide)?</b></p>
<p><i>Undoubtedly there are former distributors like Dr. Taylor who have become disenchanted with the business opportunity, just as there are in many industries.</i></p>	<p><b>A 99.94% loss rate is not normal for a legitimate "business opportunity," but is for a recruiting MLM. As well might a "business opportunity" sign be posted above gambling tables in Las Vegas. See my <i>Report of Violations of the 1994 [FTC] Order for Nu Skin to Stop Misrepresenting Earnings of Distributors . . .</i></b></p>
<p><i>However, there are hundreds of thousands of others who continue to appreciate the opportunity to achieve their goals, whether they be earning a little extra pocket money each month or they seek the freedom to quit the traditional corporate world and own their own business.</i></p>	<p><b>Those who do "achieve their goals" do so at the expense of a multitude of unwitting downline victims. And the notion of a part-time income for Nu Skin's highly leveraged compensation system is a huge misrepresentation, especially if all expenses are subtracted from revenues - for a net (loss) figure. See Appendix A in the <i>Report of Violations</i> report and my own story below.</b></p>
<p><b>Background:</b> <i>Jon M. Taylor is a self-appointed crusader opposed to the network marketing industry, particularly Nu Skin Enterprises</i></p>	<p><b>No one appoints a genuine crusader to anything, much less a whistleblower. Does the writer expect that Nu Skin would appoint a crusader against its own program or against the MLM industry?</b></p>
<p><i>He has formed a non-profit corporation called the Consumer Awareness Institute. Dr. Taylor was a NuSkin IDN distributor for a short time. He claims to have been "very successful" during his year with Nu Skin. However, in the forward of one of his books he writes of changing from an "outspoken critic of network marketing to an enthusiastic convert" before his dream soured and his wife persuaded him to give up the pursuit of wealth.</i></p>	<p><b>My "conversion" and subsequent disillusionment is an important part my story. In fact, it would not have been possible to fully decipher the deceptions in the Nu Skin program without having at one time been a committed participant. It became apparent after having made it to the top 1% of all distributors, while receiving checks of only \$246 a month against expenses exceeding \$1500 a month, the "opportunity" was very different from what was represented. Extensive research showed that it was rare for anyone to make a profit. The more I researched the topic, the more my conclusions were confirmed.</b></p>
<p><i>Dr. Taylor is fond of acquiring public data about Nu Skin and then "torturing" it until it suits his purposes.</i></p>	<p><b>One attorney with years of MLM litigation experience laughed at the idea of my "torturing" the data. Who tortured the data? Nu Skin was given at least four opportunities to rebut my analyses with valid numbers. They failed to do so all four times.</b></p>
<p><i>He has challenged the way the company reports average distributor incomes - despite its being in the prescribed format required by the Federal Trade Commission</i></p>	<p><b>The "prescribed format" allowed by the FTC has been challenged in correspondence with the Enforcement Division officials, who now have better format input. The FTC has been petitioned by numerous petitioners for better disclosure by MLM companies.</b></p>

<p>- as well as the structure of the network marketing model, the pricing of products, the ethics of the industry,</p>	<p><b>Read <i>The 5 Red Flags (cited above)</i>, and then evaluate the structure, product pricing, and ethics of the typical MLM. New recruits are being defrauded by MLM's like Nu Skin.</b></p>
<p>and even the company's philanthropy.</p>	<p><b>There they go again on the philanthropy-credibility connection.</b></p>
<p><i>Dr. Taylor forgets that salespersons in any organization have the same motivation: to earn money. He labels that desire "greed" and condemns it in MLM. In traditional businesses national sales managers motivate regional ones, who motivate district ones, who motivate the salesmen, etc. The same is true in retail where the store manager motivates the assistant store manager, who motivates the department managers, who motivate the salesmen because they all get bonuses from the sales of those below them in the organization.</i></p>	<p><b>It is safe to say that the writer of this statement (most likely someone on staff who has neither been a distributor nor a direct sales person) has not had a fraction of the sales and marketing experience I have had - nor a wall full of awards for successful performance. I know the difference between legitimate selling and a scam. See Section D-3 and Appendix D in the above-mentioned <i>Complaint of Violations</i> report - and my more extensive report on defining characteristics of recruiting MLM's [op cit]. The latter makes a clear distinction between compensation systems in a recruiting MLM and legitimate retail or direct sales operations.</b></p>
<p><i>He says MLM companies claim distributors can make millions. Laws prohibit MLM companies and distributors from making earnings claims. In Nu Skin, distributors are penalized or terminated if found violating this stricture.</i></p>	<p><b>The writer of this statement should attend some Nu Skin recruitment or opportunity meetings. And it would be good if while he was there he would open his eyes and ears to observe what goes on.</b></p>

**When I discovered how unfair, and deceptive this industry is and how few people – including regulators – understand the consequences of MLM participation, it seemed right to use my unique background and skills to challenge the industry and to provide guidance to prevent consumers from being victimized.**