Multilevel marketing (MLM), also known as network marketing is booming. Some experts predict that 50 to 60 percent of all goods and services in the United States will be sold through MLM methods during the 1990s. MLM uses people, rather than retail outlets and advertising, to sell and promote its goods and services. In addition to benefiting the companies that use it, MLM provides an opportunity for individuals to earn incomes as independent distributors because start-up costs are low and the potential for earnings is high.

A major player in MLM is Nu Skin International. This privately owned company sells high-priced skin-care, hair-care, and nutritional products to the public through 100,000 active independent distributors. Nu Skin has devised a complex MLM that spans the United States and many other parts of the world, including Canada, Hong Kong, Japan, Taiwan, New Zealand, and Australia.

**WHAT IS MLM?**

MLM is a method of personal selling in which customers have the option of becoming product or service distributors, who in turn develop “downlines,” or levels of distributors beneath them, all levels sharing in the profits of the level(s) below them. MLM companies bypass traditional wholesaler-retailer arrangements and rely on networks of independent distributors to reach potential customers.

Although the MLM approach has been used by MLM giants such as Amway and Shaklee since the late 1950s, the industry itself is still in its early stages. MLM was once restricted to personal care and household products, but has since expanded to such items as computer programs, financial advice, travel packages, books, and many other products and services.

**How MLM Works**

MLM is essentially the personal selling of products and services through a tiered structure of independent distributors. Companies that chose MLM as a distribution channel make their offering available to people willing to work on 100
percent commission. In exchange for selling merchandise and signing up new distributors, these entrepreneurs receive commission income and the opportunity to build their own sales networks. New distributors who are recruited by existing distributors also have the opportunity to recruit others. The result is an expanding MLM distribution system.

Ideally, the relationship between a MLM company and its distributors benefits both parties. From the company’s point of view, the costs of supporting the distribution network, providing brochures, audio and video tapes, holding presentation meetings, warehousing, and transporting merchandise are less than that of using retail outlets. From the individual distributor’s perspective, the time and minimal start-up costs, and other expenditures, should be outweighed by the profit opportunity.

MLM has both advantages and disadvantages that companies seeking to use it, and prospective entrepreneurs seeking to become involved in it, must evaluate carefully. Advantages include: a high earnings potential, a relatively small capital investment, being your own boss, and operating a business from home. The disadvantages include: long hours, potential difficulty in selling, the constant need to stay motivated, and the need to stay active or loose MLM network benefits.

*The Multiplier Effect*

From the participant distributor’s perspective, the key to making money in MLM is the multiplier effect. With that effect, the amount of money earned is directly related to the distributor’s ability to sell the product or service and the recruiting of others to sell for him. Most descriptions of how money is made in MLM place the burden for ultimate success on the individual seller, although it really also depends on which MLM company is involved.

Initially, the distributor (A) makes money at the personal use and customer (Customers) contact level by selling products or services to friends and others (see Fig. 4–1). This income is computed by multiplying the sales commission rate by the total sales volume. Thus, if the commission rate is 50 percent of the product’s retail price, on sales of $1,000, the seller (A) would receive $500.

With the multiplier effect, or the ability to make money from the sales of others, those people (B) brought into the seller’s (A) MLM structure, and those that they, in turn, bring in themselves also contribute to the income of seller (A) (Fig. 4–2).

If seller (A) brings in three other people (B), who, in turn, bring in three additional people (C), the business would look like Figure 4–3. In this structure, seller (A) would continue to earn a 50 percent commission on all the merchandise that (A) personally sells to customers plus a percentage of the sales generated by each of the 12 network members. Depending on the terms of the agreement with the MLM company, the average amount of that percentage is usually from 5 to 20 percent. With 12 distributors selling a total of $12,000 worth of merchandise, at a 10 percent commission rate, seller (A) would receive $1,200 in income. Over time, the 12 person downline would hopefully grow into a huge structure as others (D) are added (see Fig. 4–4).

Each MLM organization has its own marketing plan describing how many levels seller (A) can get credit for and the percentage payout at each of the levels.
The Nu Skin International marketing plan is very clear on this point. The maximum number of levels is six. In general, some MLM organizations allow a seller or distributor to have five levels, while others allow seven or more. And, the commissions received from the levels in the downline also vary by MLM firm. Usually, the more levels below seller (A), the more money he or she makes in commissions, although some MLM firms such as Nu Skin do not pay commissions beyond a fixed number.

**Ways to Generate Income**

Although there are a number of different types of compensation plans utilized by MLM companies, Nu Skin International offers two main earnings opportunities:

- **Commissions and personal sales.** This is income from goods sold directly to consumers. It is the difference between the wholesale price, what is paid by seller (A), and the selling price seller (A) receives from his customers.

- **Group bonus** This is the percentage seller (A) receives from sales volume generated by the members of his downline.

**UNDERSTANDING MLM FIRMS AND THE INDUSTRY**

The strength of a MLM company can be measured in many ways: the number of years it has been in business, demonstrated financial success, position within its industry, the quality of its management team, its marketing plan, and so on. In examining these factors, along with any others, you can get a sense of the direction in which the company is headed, its ability to consistently deliver the quality products, and the leadership advice necessary for building a profitable network.

These factors, years in business, financial success, and industry position, are all historical in nature. They show what the company has done, but not necessarily what it is capable of doing. To stay successful, a company must know how to make the best use of its resources and be able to anticipate and react to change. This is why it is important to pay close attention to a company’s management team and overall marketing strategy. Frequent issues involve the professional and educational backgrounds of the top managers in the company, how long have they been involved in MLM, the new products or services the company is planning to offer, pricing or promotion changes being developed, and the consumer groups identified as target markets.

Another major issue is whether the MLM company operates in an industry that is growing or shrinking. For example, during the 1970’s, when the nation’s birth rate was low, companies that sold baby-related goods, infant clothes, toys, furniture, and personal-care products fared badly. During the 1980’s, though, when the “baby boom” generation started having children, the baby products industry took off.

In addition to reflecting the times, the industry should be one that is viewed favorably by the public and the press. Because network marketing is built around “friends telling friends” about the products or services they represent, it is impor-
tant for the industry to have a positive image. Otherwise, the sellers are likely to end up spending more time defending the company than selling its products.

WHAT MLMs DO NOT TELL PROSPECTIVE SELLERS

Advertisements and recruiters promoting MLM always stress the income potential and the multiplication of sales due to the proliferation of people working in the seller’s downline. They tend to ignore the following factors that work against success as a MLM participant:

1. There are costs associated with recruiting and sponsoring new members.
2. Frequently people who join stop buying the company’s products shortly thereafter.
3. Many distributors make little or no effort to sponsor others or to distribute the company’s products. They may be good customers because they still buy products.
4. It costs distributors dearly to get dropped for insufficient sales because they lose their place in the pyramid.
5. The companies sometimes fail to make a profit and go out of business, leaving the distributorships worthless.
6. The MLM company, if it fails to provide a genuine product or service or if its advertising is overzealous, may face costly regulatory actions that affect distributors.

AVOIDING PYRAMID SCHEMES

Some MLM companies operate genuine marketing networks while others operate illegal pyramid schemes. Because both have the same organizational structure, it is easy to confuse them. Legitimate MLM companies generate income from sales of a product to consumers; pyramids generate income simply from bringing in a new member and charging them fees.

Pyramid schemes (also known as “Ponzi schemes” after the man who originated the concept) operate much like a chain letter with newcomers to the group (or chain) paying money to those already in the group. Once in the pyramid, the only way for a pyramid member to make money is to bring in new people who, in turn, pay a fee. The problem with pyramid schemes, and the reason that they are illegal, is that only the first people who join have a chance of making any money. Eventually the pyramid collapses when the people on the bottom discover that there is no one left to bring into the group.

Some of the more devious pyramid schemes actually do offer a product for sale, but the ‘product’ is nothing more than window dressing. Rather than selling it to customers at a profit, distributors at one level in the pyramid sell it at a profit to the distributors on the level beneath them. Those distributors do the same. And so the product goes, passing from one level in the pyramid to the next, until finally
those distributors on the bottom are left “holding the bag,” stuck with overpriced goods that cannot be sold.

Two of the most common tip-offs that a company is an illegal pyramid scheme are headhunting fees and inventory loading. A company that uses headhunting fees pays members for bringing in new recruits who are charged an entry fee to join the organization. A company that engages in inventory loading requires new distributors to purchase large amounts of nonreturnable merchandise. Part of the company’s proceeds from each distributor’s order then goes to that person’s sponsor.

Companies operating illegal pyramid schemes generally do the following:

- Promise extremely high earnings.
- Downplay the importance of hard work and personal sacrifice in achieving success.
- Are more interested in recruiting new members than in making sales to consumers.
- Pay headhunting fees for new recruits.
- Charge a high entry fee to become a distributor.
- Do not have a product or service to sell.
- Have a product with a low repeatability quotient—people may buy once, but not on a regular basis.
- Are structured so that only the distributors at the bottom of the organization actually sell to customers.
- Require new distributors to purchase large amounts of inventory.
- Have an inadequate “buy back” policy for unsold inventory.

**Nu SKIN INTERNATIONAL**

Nu Skin International is located in a sparkling new 10-story headquarters building in downtown Provo, Utah. In the seven brief years since its founding, Nu Skin has grown into a major enterprise with 1991 projected revenues of $500 million (Figure 4-5) and about $55 million in income (Figure 4–6).

If Nu Skin is not a household name, it is because it concentrates most of its sales messages toward its distributors, relying on them to get the Nu Skin message to consumers. Nu Skin aggressively recruits sellers and distributors with powerful messages about earnings, independence, and economic freedom (see Table 4–1).

Nu Skin distributors tell prospective sellers that top distributors can earn commissions of up to $400,000 a month. This pitch is delivered at thousands of recruiting meetings and in sophisticated recruitment videotapes, including one narrated by the late Bill Bixby, the star of television’s *The Incredible Hulk*. That tape shows average people telling Nu Skin success stories.

Most Nu Skin recruiting occurs at meetings that are attended by Nu Skin distributors and the prospects they bring. At these sessions, the emphasis is not on what the product can do for the customers but rather on what selling the product can do for sellers (see Table 4–2 for a description of the line). These are not sales
FIGURE 4–5  Nu Skin International Estimated Revenues
Source: Estimated from various sources

FIGURE 4–6  Nu Skin International Estimated Income
Source: Estimated from various sources
meetings so much as inspirational gatherings aiming to get prospects to become Nu Skin sellers by becoming part of their sponsor’s downline.

At these meetings, a great deal of emphasis is placed on how building a downline and receiving commissions can result in huge incomes and other benefits. Some say that this emphasis on recruiting as opposed to selling products makes Nu Skin a pyramid scheme. However, whether Nu Skin is a pyramid is unclear and currently the subject of judicial deliberations. Generally, a MLM operation crosses the line of legality when its primary purpose is to make money from recruiting instead of from selling products to consumers. It is perfectly legal to share commissions when the commissions are earned from selling products to consumers, but it is not legal in most states to operate a MLM firm that encourages commission money derived primarily from product sales to the recruits themselves.

To become a Nu Skin distributor, there is a $35 registration fee. Recruits are also encouraged to buy a $200 kit of skin care products from the new recruits sponsor. And, those kits do involve commissions that are distributed up the downline.

Nu Skin buys nearly all of its products from outside manufacturers and, after mark ups of as much as 300 percent, makes those products available to members of its MLM sales force. The company claims it paid out about 45 percent of its revenues in commissions. At the top of the Nu Skin hierarchy are about 60 distributors known as blue diamond executives. They collect 5 percent commissions on sales from executive distributor groups as much as six levels below them. If an executive distributor fails to meet monthly quotas, that person can lose future executive commissions from his or her downline.

Becoming a blue diamond is a long journey, and the odds are long too. The first step is to become an executive distributor by meeting monthly sales quotas. Next, the seller needs two distributors he or she recruits to become executives. The seller is promoted to the next executive level and collects 5 percent commissions on executive group sales as far as two levels down. Recruiting four executives leads to another promotion and the ability to collect commissions three levels down, and so on, up to six levels deep.

To qualify as an executive the seller must personally order $2,000 of product from Provo over four months. People the seller recruits have to order $7,500 more. After that the seller’s personal quota is $100 a month. Failure to meet the quotas results in loss of position on the pyramid and the commissions that come with it.

<table>
<thead>
<tr>
<th>TABLE 4–1</th>
<th>A Nu Skin International Meeting</th>
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<tbody>
<tr>
<td>Objective: Create an environment where your “friend” can recruit you to be on his downline members.</td>
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<tr>
<td>Meetings emphasize reaching your goals, dreams, desired life style—not by selling products—but by getting others to sell for you.</td>
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<tr>
<td>Benefits: be your own boss, achieve economic freedom, anyone can do it, make money in your free time, make so much money you can quit your regular job, the products sell themselves, no capital required.</td>
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<tr>
<td>Much of the meeting involves hearing testimonial of individual successes.</td>
<td></td>
</tr>
<tr>
<td>They keep saying “don’t listen to doubters.”</td>
<td></td>
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</tbody>
</table>
TABLE 4-2  Nu Skin International Product Line

- Facial system (13 items): Intensive Eye Complex, Cleansing Lotion, Facial Scrub, Enhancer, Face Lift, Nutriol Mascara, Nutriol Eyelash, etc.
- Body care system (11 items): Body Bar, Liquid Body Luffa, Body Smoother, Hand Lotion, Glacial Marine Mud, Sunright 4, 8, 15, 24, etc.
- Hair care system (7 items): Total Performance Shampoo A and B; Gentle Conditioning Shampoo; etc.
- Interior design (5 nutritional and vitamin supplements).
- Subliminal tapes (27 motivational tapes).

There is no doubt that some of the Nu Skin stuff ends up in the garages or attics, put there by executives desperate to meet quotas and hold their rung on the ladder. Few executives focus on retailing the product to customers.

MLM IS A NUMBERS GAME

We can form a realistic idea of the profit potential of any MLM marketing plan only by considering both the positive (income) and negative (expense) forces operating. Profit, after all, is income minus expenses. MLM company promotions imply that huge amounts of money can be made. And, the company may imply that it is expanding rapidly and you must join right away before everyone in the world signs up and there is no one left to recruit. The objective is to create excitement and the sense of urgency needed to close the sale (getting you to join). These messages have been given so often that the people giving them have become believers.

In truth, however, having too many members has never been either a real problem or a real determinate of the size of the seller’s eventual downline. The downline reaches its maximum size when the recruitment rate and dropout rate exactly balance each other. Customers only have a limited lifespan. As a purely mathematical problem, and for purposes of discussion, assume that a seller wants to maintain 1,000 people in his or her downline. Assume the only limit to how long they stay is the human lifespan and that after 45 years the seller will still have 50 of the originals. The seller would have to recruit five or six new members each month to keep up with the rate at which he or she loses them. If the seller loses members because they become tired of the products or bored because they are not making money, he could be down to 50 members after just three years. Then, he would have to recruit 80 new members each month to maintain 1,000. If it costs more to recruit 90 members than there are profits from the 1,000, the whole scheme is not profitable.

Would others in the seller’s downtime help with some of this recruiting? Certainly. And, they may also share in the profits, depending on how the program is structured. The seller’s recruitment rate will depend mostly on the attractiveness of his or her offer and efficiency in spreading the message.
THE FUTURE OF MLM

Overall, MLM has a bright future. Rapid growth is being fed by individuals looking for new income opportunities and by innovative MLM companies offering products and services consumers want to buy. Many companies are also looking to MLM distribution channel opportunities as technology changes the nature of communications and marketing. MLM has great value in part because it is personal selling, basically face-to-face marketing in a world that is increasingly impersonal.

Nu Skin International is emerging as a major player in this new way to sell products and services. While Nu Skin has grown phenomenally in the last few years, there are indications that it still has significant potential. With that opportunity comes challenges. Of particular interest to those concerned is the potential impact of competitors, especially major manufactures such as Clinique and Revlon, that are adding MLM to their retailing activities; other new alternative distribution channels, such as televised home shopping; and the procedural and legal issues associated with operating a MLM firm.

What marketing strategy changes would you recommend to Nu Skin? What specific price, promotion, and product elements would you propose and why? How would you deal with the growth competition from other MLMs?

Sources


Nu Skin. The Company marketing plan, sales meetings, brochures, and other promotional materials.


