

## Debate

# The Network Marketing Controversy

*ISSUE: Is network marketing a reputable business model that offers a chance to earn income or achieve personal goals?*

---

Network marketing (also sometimes referred to as multilevel marketing) is a distribution method in direct selling wherein distributors earn income from their own sales of products and commissions from sales made by individuals they have recruited. No rewards are given simply for recruiting another distributor. Network marketing involves internal consumption, which is the purchasing of products at a discount from the firm for the distributors' own use. Many individuals committed to these products believe in the brands for their own personal use and want to 'spread the word' by creating a broader sales and communication network.

While network marketing is legal because a legitimate product is sold, it is also controversial. Some believe that network marketing resembles illegal pyramid schemes. It should be noted that a pyramid scheme occurs when no product is sold or when the product has no market value. This is an illegal activity. In a pyramid scheme, distributors pay a fee when "recruited," generating money for the scheme. The scheme collapses when distributors cannot recruit anyone else. Therefore, those at the top may benefit while newer distributors potentially lose out. One of the big differences between network marketing and pyramid schemes is that while pyramid schemes pay simply for recruiting, network marketing allows distributors to receive commissions based on *actual* sales that their new recruits have made.

The three largest network marketing companies in the United States are Avon, Amway, and Herbalife. All of them engage in varying forms of network marketing. Avon operates by having its distributors sell products to end customers with the option of recruiting others. Distributors make money off the sales from their own customers as well as from a percentage of the sales from their recruits. There is no incentive in just recruiting, and it is not required that distributors buy products for one's own personal use. Avon products are sold directly to end customers. This firm is one of the most respected cosmetic companies in the world.

Amway, which sells health, beauty, and home care products, also gives people a commission on their sales and that of their recruits. It encourages distributors to engage in internal consumption, sell products to their recruits, and go to marketing meetings. While Amway products are sometimes viewed as more expensive than competitive products, the company maintains high integrity research and product development that makes it an industry leader in many product categories. For example, its Nutrilite Vitamins are the number one vitamin supplement sold in China and is endorsed by credible athletic organizations. It is notable that Amway is the second largest direct seller in the world, which would not likely occur if it had a non-sustainable direct selling model.

Herbalife, a direct seller of nutritional supplements and weight-management and personal-care products, has achieved global success in marketing and distribution with over \$4 billion in sales annually. Distributors can make commissions by selling to end consumers as well as commissions from the sales of those they recruit. While the firm has been highly successful, hedge fund manager William Ackman has accused Herbalife of being a pyramid scheme. Some of his criticisms include the pricing of the products and the fact that over 70% of distributors

purchase the product for personal use (internal consumption). In addition, many direct sellers use word-of-mouth through their distributors more so than large investments in advertising, which occur with mass marketed items such as vitamins and cosmetics. Critics such as Ackman fail to understand that not everyone selling Herbalife products is seeking a full-time income, but instead believe in the products, enjoy the products, and want to share with friends and family as well as achieve their own personal goals.

Critics of network marketing argue that distributors make more money from the sales of those they recruit than from personally selling products. These critics fail to understand that our entire economic system is based on people developing businesses where they receive commissions on the products that they sell. This business model is used in all industries and provides a direct incentive for hard work and effectively marketing these products. While the industry is flexible and provides many sales and marketing resources for its distributors, it can be hard to succeed due to the need to maintain strong customer relationships, maintain a large network of prospects, and engage in recruiting. It can be especially difficult among those with limited business experience. Often those that succeed make a significant amount of income from selling products and having a large network of recruits. Some former distributors have criticized the industry because they spent a large amount of money on internal consumption but were not able to succeed in the industry. Most direct selling companies only require minimum purchase of products to maintain a viable relationship with the company.

On the other hand, many people enter the industry to purchase products and are not trying to earn a regular income. These people become distributors because they enjoy using the product, are offered discounts on purchases, and enjoy the social interaction. Supporters of network marketing firms such as Avon, Amway, Herbalife, and Mary Kay point out that these firms provide a large amount of training and incentives for reaching certain goals. Perhaps the biggest benefits for distributors are the opportunity to start their own businesses and learn more about how businesses operate. Even those that do not succeed can gain personally from the experience. In general, the direct selling industry has been successful, over the last 100 years, by maintaining a reputation for selling high quality products and providing the opportunity for millions to engage in part-time employment from their homes.

---

*There are two sides to every issue:*

- 1. Network marketing is a legitimate business model that allows distributors to become successful entrepreneurs or satisfy their personal goals.*
  - 2. Although it is legal, network marketing's high failure rate and constant need for recruitment makes this a controversial business model.*
-

Sources:

- Gerald Albaum and Robert A. Peterson, "Multilevel (Network) Marketing: An Objective View," *The Marketing Review*, Volume 11, Number 4, 2011, pp. 347-361.
- Daniel B. Ravicher, "Might Other Companies Be Liable If Herbalife Is A Pyramid Scheme?" *Seeking Alpha*, February 5, 2013, <http://seekingalpha.com/article/1157581-might-other-companies-be-liable-if-herbalife-is-a-pyramid> (accessed February 5, 2013).
- Karen E. Klein, "A Charm Offensive By Direct Sellers", *Bloomberg Businessweek*, June 25 – July 1, 2012, pp. 52-54.
- Duane Stanford. "Bill Ackman's Crusade Against Herbalife," *Bloomberg Businessweek*, January 14 – 20, 2012, p. 40.
- Gerald Albaum, "Multi-level Marketing and Pyramid Scheme: Myth versus Reality," *AMS Quarterly*, November 2008, p. 10.
- Jayne O'Donnell, "Multilevel Marketing or 'Pyramid?' Sales People Find it Hard to Earn Much," *USA Today*, February 10, 2011, [http://usatoday30.usatoday.com/money/industries/retail/2011-02-07-multilevelmarketing03\\_CV\\_N.htm](http://usatoday30.usatoday.com/money/industries/retail/2011-02-07-multilevelmarketing03_CV_N.htm) (accessed February 12, 2013).
- Economist, "The Bottom Line," *Economist*, January 5, 2013, <http://www.economist.com/news/business/21569051-herbalife-shorted-bottomline> (accessed February 12, 2013).
- Gregory Karp, "The fine line between legitimate businesses and pyramid schemes," *Chicago Tribune*, February 10, 2013, [http://articles.chicagotribune.com/2013-02-10/business/ct-biz-0210-herbalife-20130210\\_1\\_pyramid-schemes-mlm-companies-multilevel-marketer](http://articles.chicagotribune.com/2013-02-10/business/ct-biz-0210-herbalife-20130210_1_pyramid-schemes-mlm-companies-multilevel-marketer) (accessed February 12, 2013).
- Jody Coughlin, "Is MLM a Bad Word?" *Forbes*, September 27, 2012, <http://www.forbes.com/sites/chicceo/2012/09/27/is-mlm-a-bad-word/> (accessed February 12, 2013).