



DIRECT SELLING ASSOCIATION

## The Difference Between Legitimate Direct Selling Companies and Illegal Pyramid Schemes

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The direct selling industry has been in the news recently as a result of inquiries by a prominent hedge fund manager. These inquiries have revived long-time interest in the difference between legitimate direct selling companies and illegal pyramid schemes. As the association representing more than 200 leading firms that manufacture and distribute goods and services sold directly to consumers, the Direct Selling Association (DSA) wants to make sure that the stakeholders who are important to us – analysts, regulators, direct sellers and the millions of people who purchase our products and services – understand the difference.

The confusion is understandable. Popular culture is filled with comedic references to pyramid schemes—*Saturday Night Live*, *The Family Guy*, *King of Queens* and dozens of other network and cable shows have elicited laughs by mocking these illegal scams. However, the reality is far from funny. On one hand, pyramid schemes prey on unsuspecting victims by masquerading as legitimate direct selling companies using a multilevel compensation plan. Conversely, perfectly legitimate companies are often painted with the same broad brush as their illegal counterparts, causing marketplace confusion and perpetuating misinformed opinions about direct selling.

Here's how to tell a legitimate business from a pyramid scheme:

Legitimate direct selling companies contribute to a vibrant marketplace by selling competitive, high-quality products and services and providing a sustainable source of income for those who choose to sell those products. Specifically they:

- Provide accurate information about the company, its products and what one can expect as a seller of the company's products and services.
- Charge a nominal fee for a starter kit – the median cost for the start-up kit is \$99 and usually includes items such as samples, catalogs, order forms and other tools that help the seller begin selling.
- Have a product or service that is competitive in the marketplace and is purchased by the ultimate user.
- Require sellers to hold little or no inventory and has a buyback policy to protect against inventory loading.
- Base compensation primarily on the sale of products and services to the ultimate user. Compensation can be generated from either your own sales or the sales of others you have recruited.
- Take time to describe the business and give potential sellers adequate time to make a decision – any opportunity worth having will be there tomorrow.

Legitimate direct selling companies also promote consumer protection and guarantees. Many of these are voluntary standards that exceed the requirements of any regulations created by the Federal Trade Commission (FTC) or mandated by federal or state law. Members of the DSA have also pledged to abide by a strict Code of Ethics that outlines a high set of standards for interactions with both sellers and customers.

Pyramid schemes take advantage of and defraud people because they:

- Promise large earnings with little effort.
- Promise that one can earn a substantial income merely for recruiting people into the operation.
- May or may not be a "product" to sell, but if there is it generally has little or no actual value.
- Convince people to buy large amounts of inventory which they cannot easily sell to others and is not returnable (this is called "inventory loading").
- Charge large up-front fees to get involved, either as a direct payment or in the form of an obligatory payment for "products". Promoters of pyramid schemes will also try to pressure people to sign up immediately by suggesting the same opportunity will not be available later.
- Base compensation primarily on activity (these payments for recruitment are called "headhunting fees"). Participants are convinced to pay to get involved with the promise of receiving "headhunting fees" when they recruit others.



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### **Pyramid Scheme Operators and Critics of Direct Selling Count on Confusion**

Just as pyramid scheme operators prey on victims by using misinformation to make a bad opportunity seem too good to pass up, there are many critics of direct selling who manipulate the facts to discredit legitimate companies—or who don't even understand the differences themselves and add to marketplace confusion by spreading misinformation. They count on the fact that many consumers aren't familiar with the differences between frauds and legitimate companies. The best remedy, of course, is to be educated so you can make your own determination about what's real and what's a fraud.

Popular culture may mock pyramid schemes, but the bottom line is that they do exist and it's important to know the facts about how to identify them – both for one's own protection and to avoid missing out on the great products, services and opportunities provided by legitimate companies. Millions of Americans and people around the world benefit from the income they make through direct selling and enjoy the products they purchase. Direct sellers are the original word-of-mouth marketers – using personal recommendations to connect people and products. In a time when social media makes word-of-mouth a preferred method of gathering information and making purchasing decisions, direct selling couldn't be more relevant.