



Literature review

“The online implementation
of a Multi-Level Marketing
business model.”

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Introduction

The problem statement can be summarised as follows:

“What is the best method to implement a Multi-Level Marketing company business model online?”

Through investigating this question, online marketing techniques will be analysed, along with the structure of modern Multi-Level Marketing companies (also known as Network Marketing).

The nature of MLM is such that every business is unique, and is built on a uniquely derived system for promoting and distributing products. It would not be possible to define and investigate every business model within MLM, but they can be summarised into categories.

Current online business opportunities will also be investigated.

MLM versus Pyramid Schemes

It should be noted that when investigating MLM companies, a distinction be made between a legitimate MLM company and a “Pyramid Scheme”.

“In recent decades, pyramid schemes have become an insidious, pervasive and corrupting influence in the marketplace and community, causing financial and social harm on a global scale.” - Pyramid Scheme Alert, <http://www.pyramidschemealert.org>

An important difference between a legitimate MLM company and a Pyramid scheme is the emphasis on product sales. MLM companies would encourage sales of a line of products, and the recruitment alongside. On the other hand, pyramid schemes focus more on the recruitment, and often have no product for sale.

A second identifier of pyramid schemes is the increasing of the price depending on how far ‘downline’ the dealer is located. At some point the product out-prices itself, and can no longer be sold. In such an organisation, only the few at the top may benefit, and such systems are designed to exploit people.

Legitimate MLM companies are bound by laws and stringent controls to ensure that they represent a genuine business opportunity.

The Internet and its effect on business

World Wide Web

The development of the Internet can be divided into three generations (*"The Future of Marketing"*, 2002).

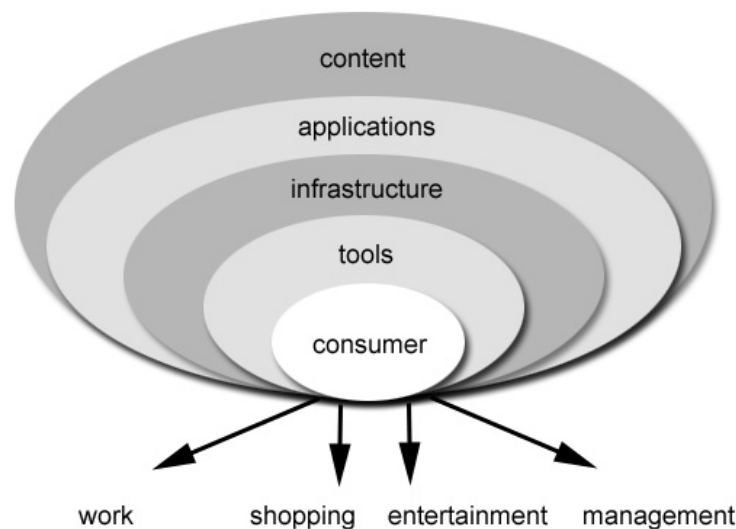
Until the early 1990s, the Internet represented a data infrastructure. It was used by government authorities, such as defence, and by universities to share information. At this point, the internet was essentially a closed network of universities, and in its first generation.

Generation two arrived with the development of a backbone, to which servers and computers were linked. Along with this, the browser provided a user-friendly way to surf, and the Internet became more commonly accepted.

The third generation facilitates more applications, and alternate methods of using the internet. Access is not limited to computers, but can be achieved through other means, such as WAP.

How The Internet is Used

The following diagram represents the structure of the Internet and its uses:



Source: Molenaar, C, 1999, *The Future of Marketing*, Prentice Hall, p.18

The *infrastructure* represents the telephone and cable networks that enable the internet to function. As the infrastructure improves worldwide, more people will gain access to it.

Applications are constructed on the basis of the possibilities provided by the infrastructure, such as web sites, shops, portals and communities that are accessed via the Internet.

Above applications is the *content*. The content is the overriding reason for a visitor to a web site or online application. It also determines the length of time a visitor may stay.

In order to access information and sites, users can use a range of *tools*. These can include WebTV, WAP-enabled telephones, and computers. Internet access is expanding into new technology, and may be used in items as diverse ways as washing machines and refrigerators.

Consumers, at the centre of the structure, determine the acceptance and use of the Internet. The consumers' use of the Internet can be divided into four categories: *working*, *shopping*, *entertainment* and *managing*.

Working

The Internet has led to many changes in working methods. Ease of communication has led to less face to face contact, and the opportunities to work from home allow people more flexibility in working.

Shopping

The need to go out to shops has diminished along with the necessity to travel to the workplace. Items can be ordered via the Internet and delivered to the user's home. The information-delivering capabilities of the Internet allow for convenient comparison of competing offers, and consumer information promotes informed choice.

A disadvantage of online shopping is the loss of the tactile characteristics. It is not possible to touch or see the objects before purchase. Such items as clothes would therefore not make the transition well.

Entertainment

Online communication can be extended to chatting, forums and community sites. Newsgroups are also a popular option.

As the Internet becomes more popular, and broadband access increases, the entertainment capabilities will be expanded.

Managing

The ability to manage finances and investments online is a relatively new development. Web sites such as Quicken.com, Smartmoney.com or Fool.com have been developed to offer professional advice and guidance.

Future applications may allow the Internet to play a larger part in people's daily lives.

The Internet as a Marketing Tool

“...with the power of network marketing combined with the power of the internet ... we will purchase nearly everything from network marketing companies. All things will be available in virtual malls for you to view and purchase” - Rod Nichols

Customers

The growth of the Internet brings with it new opportunities for contacting, providing support and selling products. As the customers can find information about products and companies before buying or signing up, they can afford to be choosier, and better informed in their choices. For example, it may be easier to find, and cheaper to order a book from a site such as Amazon.com than from the local bookstore.

The consequences can be summarised as follows:

- An independent customer who makes careful choices;
- A customer who can choose from a multitude of suppliers;
- A customer who will no longer let himself be bound to one particular supplier – as a result customer loyalty will diminish in favour of the possibility of making selective and careful choices;

With a larger range of choice, customers are in a better position to shop from different suppliers. It is often beneficial for web sites to collaborate into groups of related products, or take part in affiliate marketing.

Suppliers

The Internet can be used to monitor and inform the company of stock levels and sales trends, and even inform suppliers automatically when stock levels are low. While these systems have been in place for some time, the Internet has made the integration of such systems easier.

In order to encourage customer to shop online, the order fulfilment process must be as streamlined and efficient as possible. This requirement has led to the development of specialist companies, their sole purpose being to process and deliver products.

The nature of the Internet allows companies to collaborate in their purchasing, resulting in a stronger bargaining force able to negotiate better prices.

The global nature of the Internet allows more options for sourcing products from overseas providers. The price reductions can then be passed on to the customer, offering greater incentive to shop online.

Multi-Level Marketing (MLM)

There are many resources dedicated to Multi-Level Marketing, including web sites, books, mailing lists, journals, magazines and even cable television channels (such as “The Success Channel”, USA).

What is Multi-Level Marketing?

“It is a strategy for selling products whereby independent salesmen are permitted to recruit other salesmen and to draw commissions from the sales of their recruits.” – Wave 4, Network Marketing in the 21st Century, 1999.

To the manufacturer or company, MLM represents a means to distribute products without the need for a salaried sales force. To the individuals within the business, it is an opportunity to build a sales organisation which will eventually lead to financial independence.

The Origins of MLM

Multi-Level Marketing is believed to have been successfully employed for the first time by Carl Rehnberg. In the 1920s, Rehnberg developed his own unique range of food supplements. In 1934, he started a company to distribute the supplements, called the California Vitamin Company, and later renamed Nutrilite Products Inc.

Nutrilite operated until 1945 as a direct sales company, before introducing a new payment system. Under the new system, distributors could introduce new distributors to the company, and earn 3% commission on their sales. This commission continued indefinitely, and allowed distributors to build their own sales force.

The strength of the system lay in the fact that each distributor would earn commissions not only from their own recruits, but from distributors recruited by their recruits, and so on. When a recruit introduces new recruits to the company, it forms what is described as a *downline*. The recruiter is referred to as the *sponsor*.

As distributors introduce new distributors, and they introduce more distributors, the company can grow at a geometric rate. The number of recruits can quickly become very large, resulting in *leverage*, which can be used to develop a residual or ongoing income.

Duplication and Leverage

For a MLM business to succeed, it should be built using a system that can be duplicated. In essence, each distributor is a microcosm of the entire organisation, in charge of running their network of distributors. To maximise the chances of success, each distributor is taught by a mentor (usually their sponsor) to duplicate the system in order to build their own network.

The application of this duplication results in an effect known as leverage. A large number of people, only selling products or services at a modest level, can result in a strong sales force and can result in a strong earning potential.

Leverage represents an opportunity for people to earn more than can be earned while working for a linear income. The majority of people earn either a salary, commission, or are paid on an hourly basis. These incomes are limited by either the number of hours in the week or number of potential customers a salesperson may speak to in a day.

When the principle of leverage is applied, it is possible to earn many times the amount that can be earned with linear income, by using the income generating potential of a network.

Compensation Plans

Compensation plans are the payment structures used within MLM businesses. While all are based on the concept described above, there are many implementations of payment structures. Each results in a different kind of organisation, and can require very different techniques in order to succeed.

The variety of compensation plans results in some that suit certain kinds of people. However, all are based on six main governing variables.

1. Depth

When recruiting new distributors, they are 'placed' into a structure. This can be wide or deep, and in some companies the width or depth can be limited. The width is the number of people that are placed directly under the recruiter, known as the 'frontline', and depth is the number of levels down from which a distributor can earn commission.

2. Qualifications

Most organisations require that in order to receive a commission, each distributor must remain 'active'. This usually involves purchasing a minimum amount of stock from the company each month.

These quotas can affect the style of the organisation. For example, if the quotas are placed high, there can be pressure to buy a lot of product, possibly more than can be sold. However if the quota is set too low, there can be little incentive to sell product, resulting in a lazier organisation.

3. Front / Back End

Some organisations offer greater commissions on certain levels, referred to as 'front end' and 'back end'. The front end is the initial recruits, positioned directly beneath the sponsor.

With higher commissions on the front end, money can be earned faster and more easily. Whereas with commissions placed on the lower levels, it would require more work and a longer time to build a profitable organisation.

Most well established plans place greater emphasis on the lower levels, in order to encourage longer-term development of networks. The geometric growth of the network also plays a part when considering commissions on the lower levels, as they would contain many more people than the higher levels.

4. Payout

Payout is described as the percentage of the total product price that is paid to distributors in the form of commissions.

While a high payout can be attractive to distributors, it can result in expensive products that are difficult to sell or provide little income for the company. It is generally accepted that a lower payout on a product that sells in greater numbers is better than a high payout on a slow-selling product. As explained by Leonard Clements in *Inside Network Marketing*, "Seventy-five percent of zero is still zero".

5. Breakage

Breakage is the use of an arbitrary measure to represent the level of sales achieved by a distributor. For example, a distributor may sell £1,600 of stock in a month, but the company may only pay commission based on £1,000 units. In this way the company would describe the sales as £1,000 of *bonus volume* and calculate commissions based on £1,000.

Companies choose to use a method such as this in order to offer more attractive rates of *payout*.

6. Type of Plan

There are four main types of compensation plans, which are known as the *Stairstep / Breakaway*, the *Matrix*, the *Unilevel* and the *Binary*.

The Stairstep / Breakaway Plan

This plan is structured like a staircase, in that as the number of distributors in the downline grows, and the amount of product sold increases, the sponsor climbs in status and gains a higher rate of commission. They may also be entitled to commissions on a greater number of levels.

The distributors that have been introduced are also climbing the staircase, and when they achieve a certain status, they 'break away' along with their downline. When this happens, the sales of this group no longer count toward the quota of the original sponsor, and the level of commission from this group is often reduced.

However even if the 'breakaway' group draws a lower rate of commission, it is possible to earn more on this group, as the total earnings of the group are considered, rather than simply the number of levels under which the sponsor would usually earn a commission.

This plan allows 'deeper' structures than any other, and the greatest earning potential.

The majority of companies that have survived in MLM have used this method. While being one of the more complex methods, the high corporate profits it generates offer a financial stability not present in some plans.

This plan tends to also be weighted toward the back end, and would reward more in the longer term. There is a tendency in more modern variations of this plan to lighten the monthly quotas and offer higher front end commissions, in order to allow for more short term earnings.

The Matrix Plan

Whereas in the previous plan the number of people in a sponsor's frontline was unlimited, the Matrix plan sets fixed limits on the structure of the downline.

For example, in a 2 x 12 plan, the first two people to be introduced would be placed in the sponsor's frontline. The third person would spill over to the next level, beneath the first person. The commission structure would take into account sales based on the first twelve levels beneath the sponsor.

The advantages of such a plan are that it is simple to understand and explain. It is also easier to manage a small number of frontline distributors than the larger numbers in other plans.

On the other hand, the fixed structure can result in limits on the number of distributors in an organisation, which can stifle growth. The automatic spill over can result in laziness, as distributors' downline is built up by their sponsor.

The Unilevel Plan

This plan is similar in a number of ways to the Stairstep / Breakaway plan, though it does not involve breakaway groups.

Essentially this plan sets a limit on the number of levels from which commission is calculated, but no limit on the width. The sponsor can earn higher commissions and earn on deeper levels by meeting specific monthly quotas.

It is an easy plan to explain and operate, and allows an unlimited number of frontline recruits. In some cases, higher commissions are offered on level

three, encouraging sponsors to place distributors in the frontline of other distributors.

While having no limit to the number of recruits in the frontline can result in a strong sales force, it also places extra pressure on the sponsor to teach a larger number of distributors.

The Binary Plan

A Binary plan is made up of two *legs*. The sponsor begins with a frontline of two distributors, and further recruits spill over beneath them, similar to a Matrix plan.

The organisation then grows within the two legs, and commissions are paid on the weaker of the two. The stronger leg generally would not generate commissions.

Though the commissions are only paid on one half of the organisation, they are calculated on the *entire* leg, no matter how many levels it involves. In this way it can generate a large income.

However, as the stronger leg is generally not considered for commissions, an unbalanced organisation would result in a large amount of income for the company, but little for the distributor.

Online Opportunities

A search in Google returns many thousands of MLM websites. A few have been selected which represent different methods and approaches to the online marketing business.

Buy MLM Tools (<http://www.buymlmtools.com>)

This is a MLM-themed online shop, specialising in books and audio tapes about Network Marketing. It has an affiliate scheme that pays a percentage to the referrer. An interesting addition is the use of cookies to store the referrer information, so that if a customer returns and purchases again, the original referrer continues to benefit.

eVisionLink (<http://www.evisionlink.com>)

eVision was established by the New Vision International company. The product was the 'webCenter', a customisable web site that allowed people with little technical skills get online.

The webCenter was set up as a tool to sell webCenters, offering a commission to the owner of the webCenter for any sales.

Due to technical difficulties, eVisionLink no longer functions, and its member sites are expired as of April, 2003.

Euphony (<http://www.euphony.com>)

A telecommunications company, Euphony began marketing their services via a MLM system in 1998.

Their system is based on the Unilevel plan, paying out over seven levels. The commissions are paid on the phone use of customers introduced by the distributor, based on the number of 'points' created during a calendar month.

When qualified to "Gold" level, distributors qualify for double the commission levels.

Gold Glory (<http://www.gold-glory.net>)

Gold Glory sells subscriptions to its monthly newsletter. At \$15 to join, each direct sale results in \$5.00 commission.

The compensation plan is then based on a 3 x 8 Matrix plan. In this, the first three distributors are placed directly beneath the sponsor, and further recruits would spill over to the lower levels. This plan allows a maximum of 6,561 in any distributor's downline.

Vitastar International (<http://www.vitastarintl.com>)

Vitastar sell a range of vitamin and health products.

The compensation plan is a Unilevel plan, weighted heavily toward the second level. The aim of this plan is to encourage sponsors to work with their immediate downline to ensure that they recruit people.

Happeneurs (<http://www.happeneurs.com>)

This is an online marketing site, which specialises in web promotion techniques

This site uses an affiliate program along with a MLM plan. Their program includes promotional flash movies and marketing guides to help sell the compensation plan to new recruits.

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(<http://www.internet-mlm-home-business-opportunity.com/articles/The-Future-of-Network-Marketing.htm>)

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