

Pyramid Schemes: Not What They Seem!



Don't make a costly mistake!

Thousands of Americans have lost millions of dollars participating in pyramid schemes. Many of the victims knew they were gambling (although they didn't know the odds were rigged against them). Many others, however, thought they were paying for help in starting a small business of their own. These people were fooled by pyramid schemes disguised to look like legitimate businesses.

The purpose of this brochure is to help you avoid falling victim to pyramid schemes, whether simple or disguised. Simple pyramid schemes are similar to chain letters, while disguised pyramids are like wolves in sheep's clothing, hiding their true nature in order to fool potential investors and evade law enforcers.

What is a pyramid scheme?

Pyramid schemes are illegal scams in which large numbers of people at the bottom of the pyramid pay money to a few people at the top. Each new participant pays for the chance to advance to the top and profit from payments of others who might join later. For example, to join, you might have to pay anywhere from a small investment to thousands of dollars. In this example, \$1,000 buys a position in one of the boxes on the bottom level. Five-hundred dollars of your money goes to the person in the box directly above you, and the other \$500 goes to the person at the top of the pyramid, the promoter. If all the boxes on the chart fill up with participants, the promoter will collect \$16,000, and you and the others on the bottom

level will each be \$1,000 poorer. When the promoter has been paid off, his box is removed and the second level becomes the top or payoff level. Only then do the two people on the second level begin to profit. To pay off these two, 32 empty boxes are added at the bottom, and the search for new participants continues.

Each time a level rises to the top, a new level must be added to the bottom, each one twice as large as the one before. If enough new participants join, you and the other 15 players in your level may make it to the top. However, in order for you to collect your payoffs, 512 people would have to be recruited, half of them losing \$1,000 each.

Of course, the pyramid may collapse long before you reach the top. In order for everyone in a pyramid

scheme to profit, there would have to be a never-ending supply of new participants.

In reality, however, the supply of participants is limited, and each new level of participants has less chance of recruiting others and a greater chance of losing money.

Things you should know about pyramid schemes

1. They are losers. Pyramiding is based on simple mathematics: many losers pay a few winners.
2. They are fraudulent. Participants in a pyramid scheme are, consciously or unconsciously, deceiving those they recruit. Few would pay to join if the diminishing odds were explained to them.
3. They are illegal. There is a real risk that a pyramid operation will be closed down by the officials and the participants subject to fines and possible arrest.

Why would anyone pay to join a pyramid scheme?

Pyramid promoters are masters of group psychology. At recruiting meetings they create a frenzied, enthusiastic atmosphere where group pressure and promises of easy money play upon people's greed and fear of missing a good deal. Thoughtful consideration and questioning are discouraged. It is difficult to resist this kind of appeal unless you recognize that the scheme is rigged against you.

Disguised pyramid—wolf in sheep's clothing

Some pyramid promoters try to make their schemes look like multilevel marketing methods. Multilevel marketing is a lawful and legitimate business method which uses a network of independent distributors to sell consumer products.

To look like a multilevel marketing company, a pyramid scheme takes on a line of products and claims to be in the business of selling them to consumers. However, little or no effort is made to actually market the products. Instead, money is made in typical pyramid fashion, from recruiting. New distributors are pushed to purchase large and costly amounts of inventory when they sign up.

For example, you might have to purchase \$1,000 of nearly worthless products in order to become a "distributor." The person who recruited you receives \$500 (a fifty percent commission) and \$500 goes to the top (the company, in this case). Notice the similarity to the simple pyramid scheme described earlier.

Most disguised pyramids, however, are not this easy to unmask. Pyramid schemes often choose products which are cheap to produce but which have no established market value, such as new miracle products, exotic cures, etc. This makes it difficult to tell whether there is a real consumer market for the products. The best way to avoid a disguised pyramid fraud is to know what to look for in a legitimate income opportunity.



Multilevel marketing—legitimate income opportunities

Multilevel marketing is a popular way of retailing in which consumer products are sold, not in stores by sales clerks, but by independent businessmen and women (distributors), usually in customers' homes. As a distributor you can set your own hours and earn money by selling consumer products supplied by an established company.

In a multilevel structure you can also build and manage your own salesforce by recruiting, motivating, supplying and training others to sell those products. your compensation then includes a percentage of the sales of your entire sales group as well as earnings on your own sales to retail customers. This opportunity has made multilevel marketing an attractive way of starting a business with comparatively little money.

How to tell the difference between a legitimate business and a disguised pyramid scheme

Pyramid schemes seek to make money from you (and quickly). Multilevel marketing companies seek to make money with you as you build your business

(and theirs) selling consumer products. Before you sign up with a company, investigate carefully. A good way to begin is to ask yourself these three questions:

1. How much are you required to pay to become a distributor?
2. Will the company buy back unsold inventory?
3. Are the company's products sold to consumers?

1. Start Up Cost? IF THE COST IS SUBSTANTIAL, BE CAREFUL! The start-up fee in multilevel companies is generally small (usually for a sales kit sold at or below company cost). These companies want to make it easy and inexpensive for you to start selling. Pyramid schemes, on the other hand, make nearly all of their profit on signing up new recruits. Therefore, the cost to become a distributor is usually high.

CAUTION: PYRAMIDS OFTEN DISGUISE ENTRY FEES AS PART OF THE PRICE CHARGED FOR REQUIRED PURCHASES OF TRAINING, COMPUTER SERVICES, PRODUCT INVENTORY, etc. These purchases may not even be expensive or "required," but there will be considerable pressure to "take full advantage of the opportunity."



2. Buy-Back of Inventory? IF YOU COULD BE STUCK WITH UNSOLD INVENTORY, BEWARE!

Legitimate companies which require inventory purchases will usually “buy back” unsold products if you decide to quit the business. Some state laws require buy-backs for at least 90% of your original cost.

3. Sales to Consumers? IF THE ANSWER IS NO (OR NOT MANY), STAY AWAY! This is a key element. Multilevel marketing (like other methods of retailing) depends on selling to consumers and establishing a market. This requires quality products, competitively priced. Pyramid schemes, on the other hand, are not concerned with sales to end users of the product. Profits are made on volume sales to new recruits who buy the products, not because they are useful or attractively priced, but because they must buy them to participate. Inventory purchases should never be more than you can realistically expect to sell.

How to protect yourself from a bad investment

1. **Take your time.** Don't let anyone rush you. A good opportunity to build a business in a multilevel structure will not disappear overnight. People who say “get in on the ground floor” are implying that people joining later will be left out in the cold. BEWARE!

2. Ask questions:

- About the company and its officers.
- About the products—their cost, fair market value, source of supply, and potential market in your area.
- About the start up fee (including required purchases).
- About the company's guaranteed buy-back of required purchases.
- About the average earnings of active distributors.

3. **Get written copies of all available company literature.**

4. **Consult with others** who have had experience with the company and its products. Check to see if the products are actually being sold to consumers.

5. **Investigate** and verify all information. Do not assume that official looking documents are either accurate or complete.

Where to go for help

For help in evaluating a direct selling company, visit the [Direct Selling Association](#), the [Better Business Bureau](#), your local district attorney or your state attorney general.

If you suspect that a company may be an illegal pyramid scheme, contact your state and local law enforcement offices and the [Federal Trade Commission](#).

For more information about direct selling, visit [direct-selling411.com](#). To find out more about ethical business practices, visit [www.dsef.org](#)

Founded in 1973, the Direct Selling Education Foundation (DSEF) stands up for consumers and champions ethical entrepreneurship through its partnerships with consumer advocates, educators and students, public policy officials, and the small business and entrepreneurship communities. DSEF's programs engage and educate the public on the ways direct selling empowers individuals, supports communities and strengthens economies worldwide.

As DSEF enters its 40th year, the spirit of partnership continues to be central to every relationship and program the Foundation undertakes. The organization maintains a long-standing track record of effective partnerships that require commitment and nurturing. It is through these relationships that DSEF develops programs that create a market climate of trust for the direct selling industry.

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