



STACKED AFFAIRS – VERSUS MLM (Or: GUISED PYRAMIDS – WOLF IN SHEEP’S FUR)

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Abstract *The model of pyramid, invented by the ancient Egyptians was used by mankind in different ways, during the time. In our research we try to underline the link between some pyramidal schemes: that means our research has to show a comparative approach of two aspects apparently without any link, but reality shows that there are both resembles, and differences between them. The common element is not only the pyramid shape, but also the financial scope which they are used for. More by token, they are using this lait-motive of pyramid not only for earning huge sum of money, but also without paying taxes on it. Besides these common features, there are also a clear difference between them, i.e. one of these action (the pyramidal games) are not giving any product for the sum of money given by the participants, as the other activity (the MLM used in cosmetics and nutritional supplements industries) uses goods given instead of paying money by the involved people.*

Key words:

Pyramid, MLM
(Multi-Level Marketing),
money, cosmetics,
nutritional supplements,
stacked affairs

JEL Codes:

O24, E40, M31

1. Introduction

The mirage of easy earning the money determines some people to trust in various and ingenious promises of multiplying the invested sums, without any efforts. History reveals us the people’s infinite resourcefulness. They always tried to make their life better and better, and thus, they invented different ways of earning money. Their gumption created various means for gaining interests, one more intelligent than another. The most discoveries were used for mankind’s welfare, and for the human society as a whole. Nevertheless a certain part of these has an obvious malefic character, directed only to earn much money, avoiding taxes and duties. Most of them could be the stacked affairs, and furthermore, some of them are linked to multi level marketing.

2. Methodology of research

Pyramidal schedules or financial stacked games are some proceedings of earning money, not always legally, and virtually built as a pyramid shape, in which the levels of it are made up of persons which are paying a certain sum of money, when entering into the

scheme. Our approach are not deserved to pyramidal affairs as generally speaking, but only to those based on network marketing. Most of the masked pyramids are not easy to guess, as the companies are using ingenious schemes, with new choose whether and to what extent these subdivisions are necessary. Goods, with small costs of production, and without a settled market value, but with a good price for client – so as they could be easily sold. Thus, the market study becomes difficult to establish the existence of a real demand for the sold products.

As for the network marketing – it is a business in which the companies pay for advertising only after the goods are sold. This original strategy uses the strong power of life viva voce publicity is profitable working for all participants to the affair. This manner is useful for the firm, as it has no expenses with risky advertisement in media, the company using these funds as reward for a net of independent distributors. They are coming from different environments, having various crafts, and completing their earnings with a network marketing business. This is a popular method to display and sell goods, but not in shops, only with the help of

employees. It uses independent commercial agents (named distributors). That distributor can choose the work program, earning money from purchasing of the goods from an outstanding company. The commissions, bonuses, generally speaking the earnings come from the payments of the company to the MLM distributors, on the basis of the selling volume.

3. Literature Review

The main difference between the pyramidal schemes and the legal affairs is the fact that the formers gain money on behalf of the recruited people with their money, and without giving them any products, as the network marketing companies are pulling together with the distributors, in order to earn money together, meanwhile these people developing for themselves their personal affair, from selling products or services of the firm.

These topics were theoretically analyzed, for example by Edward Ludbrook in *The Big Picture – Why Network Marketing* (Ludbrook, 2000) and *Marea Panorama* (Ludbrook, 1999, pp. 78-80) will booming and what it means to you, Paperback (1999) then by Len Clements, in his *The Coming Network Marketing Boom* (Clements, 2002) or Duval G., *Henri JACOT – Nouveau siècle, enjoin majors* (2003) and the list could continue. Starting from the theory and going to practical examples we can discuss about examples that are taking into account the theory, or they are not... So, the comparison which we have proposed from the beginning will continue, that is with the examples of pyramidal affairs versus the network marketing affairs. In the first category, avoiding a long list of pyramidal stakes, the list begins with Charles Ponzi, which in 1919-1920 years - he cheated thousands of people from New England, by convincing them to invest in a pyramidal scheme with postmarks. He promised to the credulous people that he would offer 50% profit, in 90 days, for their deposits in the Ponzi scheme, instead of 5% as bank interests were at that time. At the beginning of the activity, Ponzi began to pay the first investors from the new investments of the coming people into his scheme. Shortly, one can say that a Ponzi scheme consists in fraudulent investment operation, implying huge profits for some investors on behalf of funds invested by other persons, and not as results of the incomes which that business created.

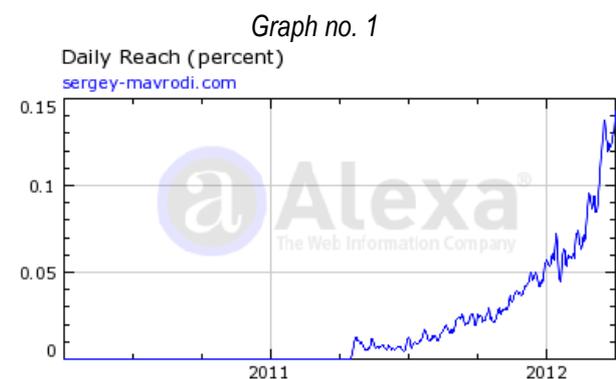
There were also other representatives of the Ponzi scheme, such as Bernard Madoff – which was considered the creator of one of the biggest such a scheme in the world, with a value of \$ 65 billion. He was judged and convicted in USA, to a punishment of 150 years of prison, even if he is 75 years old. Another

figure that tried to cheat the people from New Zealand was David Ross (63 years old), which fiddled the investors with a sum of about 400 millions of NZ dollars, that is \$ 317 million (USA), up to November last year, when his scheme collapsed.

We would stop the list with one of the biggest pyramidal system in the world – MMM-2011, whose author Serghei Panteleevici Mavrodi (a former mathematicians and deputy) has in his affair about 30 million persons from Russia and the republics from ex-USSR. They lost their money (\$4,3 million) in 1994 year, and Serghei remained four years in prison. His philosophy was that MMM-2001 to destroy the financial apocalypse, Mavrodi pledged to destroy the financial system. What is the mechanism of MMM scheme? It seems very simple, as follows: MMM-2011 wants to be a decentralized financial social structure, without any companies, no LLCs (Limited Liability Company), no contracts, no promises, no guaranties. There are only regular people exchanging money between them, based on the set of SergheiMavrodi recommendations. There is any central place where all money is kept.

MMM scheme is similar to the structure of Genghis Khan's army. In the bottom-level is a representative node of system, called "foremen".

They are managing money flows between their participants, and now on they keep money backup. There is a next level node, managing money flows between their foreman's. And thus, so is going up and up, uniting groups of people, cities, provinces, countries. Mavrodi's intention is to be the world itself. Backup money are kept only by bottom-level nodes and sometimes by participants, and each participant must have a foreman. *The Graph no. 1* shows the daily reach (percent) for Mavrodi's affair:

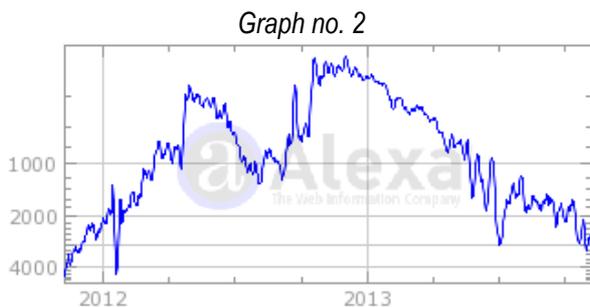


Source: www.serghei-mavrodi.com, by Alexa Web Information Company

MMM has an internal virtual currency – that is called MAVRO. When someone makes deposit – s/he buys

MAVRO. MAVRO rates always grow from 20% to 60% in a month. If someone wants to sell his MAVRO – s/he can do it at any time, at a certain rate published on MMM website, to his/her, or other foreman. It seems impossible to destroy such a structure. If the foreman disappears for any reason, the other participants are moved to another foreman, and their internal MAVRO deposits remain not affected by such incident. This is one of the most representative pyramidal schemes of our days.

The Graph no. 2 illustrates the evolution of the interest to Serghei Mavrodi's scheme:



Source: www.serghei-mavrodi.com, by Alexa Web Information Company

Someone could ask what is the link between the Ponzi schemes (which are illegally), and the MLM activity – which is a legal activity of selling goods and services – also in our country? The main resemblance is the fact that it is a very similar recruitment system, which is on the basis of some investors which are entering in the system with a sum of money, bigger and bigger. The differences are essential: as MLM is a legal commercial system, based on recommendation, in which the participants receive not only goods, but also bonuses, as per the algorithm of the company, than in the pyramidal Ponzi schemes the participants do not receive any goods, and they are freely coming into the system, without any recommendation, only to give money to the “pyramid”.

Comparatively, let see how is working the MLM systems in the cosmetics and nutritional supplements? Even if network marketing exists from the 1930's years, it becomes a serious economical force around the 1960's years, when there appeared such companies as Avon, Amway and Mary Kay, opening the way for a major extension of this industry. This development goes on, up to its top, in 1990's years, when more MLM companies were founded. At the same period, there come up a new concern for a more healthy life, and wellness. People began to interest more than ever about a new life style, a healthier one. The reasons are

not only demographical ones, but also the concern for a longer and better life. For example, many people renounce to bad customs as smoking, alcohol, and losing nights, being more interested about the means of healthy life style. Thus, the rising of the public interest for a healthy and longer life comes together with the MLM rising industry, and so, there scored an exponentially rising of the companies which are trading products for maintaining the health, and consequently, a hyperinflation of such products (Don & Nancy Failla, 1988). Nevertheless, around the 1990's years, there were a decline of the MLM system in this field, but after this, the medium were very much improved, so that up to now there are resisting the stronger and serious companies. Now, MLM system scored about 50 million members, after 55 years of activity and the forecasting are very optimistic: they suggest that the number of members in this system will double in the following 15 years. Internet is the main reason for this prospection, as it has a bigger capacity as instrument for creating and maintaining the network, and thus the relationships between members and their clients are closer.

An important problem which arises is the fiscal evasion around of millions of euro, by reselling the products “from black”, as the firms that practice this MLM system promote a sort of pyramidal commercial network. There are well-known the way of working for the firms like Avon, Oriflame, Calivita, Secom and others. They have a “deposit” – a huge one – to which they are “linked” thousands and thousands of distributors (one says that there are more than one hundred of thousands). These distributors are taking the goods, and they are reselling them to the final clients. This system ensure huge profits for the company, so as they are earning huge sums of money early, without issuing any bill, or invoice, and conclusively, without paying taxes and impositions on their profit. In real terms, almost all commodities taken by the distributors are resold from black with an addition of 30%, encouraged by the company itself. Thus, it is almost impossible to check the process by the current legal means, so as this system causes many losses for state, as VAT (Value Added Tax), profit tax, and also the taxes on the distributors' salaries are not collected. Even if in the papers of the company there are some taxed agents, but they represent only 2 or 3 percents, from the whole “army” of distributors. As the majority of the distributors could not be reworded depending on the retails of the pyramidal structure, they can buy products with discounts between 25-50%, as per quantity acquired. To translate in economical terms, that means a reduction of the basis of collecting VAT with an average of 20-25%, as the sums resulted from applying this discount as the distributors' incomes, and thus doubles

the profit from the reselling the products from black. The Romanian law cannot punish this system, as it considers that every sell which is not under cost is a legal one.

In the same line, one can say that the cosmetics firm which are practicing this MLM system in Romania, they have also many processes – almost 50 per/company, even if their common argument are that their distributors are buying the goods for their own use. This is difficult to believe, as the distributors are persons with small incomes, and they could not expend at about 2400 RON/year for cosmetics.

Besides the cosmetics companies, in Romania are also activating some companies distributing nutritive supplements, in the same MLM system (Dumitras, 2003) such as Calivita Int., Secom, Herbalife, and others, with different products, like Amway. They have important turnover, such as, for example: Amway scores 21,6 millions of euro in 2010 (that means 91 millions of RON), and a profit of 2 million RON. As this company is an apart example, because it has more kind of products, inclusively natural supplements – these having a quarter of the company turnover in the last years. Comparatively, Secom has a turnover of 5 millions of euro in 2010, which means in an obvious rising of 75% towards 2009 year; this is on market of nutritive supplements of 220 millions of euro in 2010. Another example is Herbalife Company, with it's a turnover of \$3 billion/ year.

Recently, another multi-level marketing company, a national one, that is Fortune Hi-Tech Marketing (from USA) used an illegal pyramid scheme, involving more than 100.000 people in it, as the founders of the firm were paid with over \$40 dollar in bonuses and commissions (www.marketwaveinc.com).

So, that means not only cosmetics and nutritional supplements industries are avoiding taxes, but also in other industry, which are practicing multi-level marketing. The temptation is huge, and the ingenuity of the people on the same level.

4. Conclusions

Our approach is a modest trial to invite everybody to the study of the fascinating economic field, to try to elucidate its interesting mechanisms, and to reveal its interdisciplinary connections. Economy – generally speaking, and financial area – particularly speaking have a certain mirage, which deserve to be studied, and analyzed, as they offer a lot of various knowledge, one more interesting than another, and finally give an immense satisfaction, inviting to study more and more.

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