Utah State University
DigitalCommons@USU

All Archived Publications | Archived USU Extension Publications

1999

Pyramid Schemes

Barbara R. Rowe PhD
Utah State University

Follow this and additional works at: http://digitalcommons.usu.edu/extension_histall
Warning: The information in this series may be obsolete. It is presented here for historical purposes only. For the most up to date information please visit The Utah State University Cooperative Extension Office

Recommended Citation
Rowe, Barbara R. PhD, "Pyramid Schemes" (1999). *All Archived Publications.* Paper 1328.
http://digitalcommons.usu.edu/extension_histall/1328

This Factsheet is brought to you for free and open access by the Archived USU Extension Publications at DigitalCommons@USU. It has been accepted for inclusion in All Archived Publications by an authorized administrator of DigitalCommons@USU. For more information, please contact becky.thoms@usu.edu.

UtahStateUniversity
COOPERATIVE EXTENSION

FINANCIAL FITNESS

FACT SHEET

February 2000 FL/FF-04

PYRAMID SCHEMES

Barbara R. Rowe Ph.D.
Professor and Extension Family Resource Management Specialist
Utah State University

A pyramid scheme in its purest form is characterized by a plan in which people invest in the right to sell the investment.

Here's a typical example of a pyramid scheme: You are invited by a friend, neighbor or colleague to attend an "opportunity meeting" to find out how you can earn lots of extra money. You go, thinking this may be a way to build a business of your own. A smooth-talking organizer tells you that his or her plan is an exciting short cut to riches, easy living and early retirement. To join you are required to pay $1,000 to buy a position on the bottom level of an organizational pyramid and to recruit two additional people who will pay $1,000 each. Half of your money goes to the person in the level directly above you and the other half goes to the person at the top of the pyramid.

If all the levels on a five-level pyramid fill up with participants, the person at the top will collect $16,000 and you and the others on the bottom will be $1,000 poorer. When the top person has been paid off, his or her level is removed and the second level becomes the top, or payoff level. Only then do the two people on the second level begin to make a profit. To pay off these two, 32 empty slots are added to the bottom of the pyramid and the search for new participants continues.

Each time another level of the pyramid 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 on the fifth level make it to the top. But in order for you to collect your payoff, 512 people would have to be recruited, half of them paying $1,000 each.

A pyramid usually collapses long before someone at the fifth step reaches the top. In order for everyone in the pyramid scheme to get money, there would have to be a never-ending supply of potential (and willing) participants, all of whom paid the full amount of money. In reality, the number of participants is limited and each new level of investors has a smaller chance of recruiting others and a greater chance of losing their money. The following illustration shows what would happen if one person recruited six participants, each of whom recruited six others, and so on, through eight steps. If the pyramid were extended through 10 steps, with each person recruiting six people, there would be a participant in five of every six U.S. households.

(EACH RECRUIT GETS 6 FRIENDS)

STEP	NO. OF PEOPLE
1 (you)	6 friends
2	36 friends
3	216 friends
4	1,296 friends
5	7,776 friends
6	46,656 friends
7	279,936 friends
8	1,679,616 friends

Pyramid scheme or legitimate multi-level?

Because of law enforcement crackdowns, some mid-promoters attempt to make their schemes look like legitimate multi-level marketing companies. Multi-level marketing is a lawful and legitimate business method which uses a network of independent distributors to sell consumer products, usually in the consumer's home. Distributors in a multi-level marketing company have the opportunity to set their own hours and to earn money based on their effort and ability to sell consumer products supplied by an established company.

In an authentic multi-level structure, distributors also have the opportunity to build and manage their own sales force by recruiting, motivating, supplying, and training others to sell products. Compensation then includes a percentage of the sales of their entire sales group as well as earnings on their own retail sales to customers. This opportunity has made multi-level marketing an attractive way to start a business with comparatively little money. It is not an easy means of getting rich. Successful distributors who recruit and train a large number of sellers have to assume ongoing wholesaling and managerial responsibilities in addition to their own selling duties. While managing a large network can be lucrative, it is hard work and can become a full-time job.

To look like an established multi-level company, a pyramid scheme may take on a line of products and claim to be in the business of selling them to customers. But little or no effort is made to actually sell the products. Instead, money is made in typical pyramid fashion, from recruiting new distributors.

How to Protect Yourself

When it is so obvious that a pyramid is a bad business deal, why do so many people join? The reasons are simple. 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 desire to have a high income and fear of missing a good deal. Thoughtful consideration and questioning are discouraged at these meetings. The organizer may tell potential participants that they don't have to invest (or buy the products), but it is clear that they are expected to, or would be a fool not to.

If you are approached to invest this way, here are some guidelines to protect yourself:

1. *Take your time. Do not be rushed into signing up.* An opportunity to build business in a legitimate multi-level structure will not disappear overnight.
2. *Ask questions*. Who are the company's officers? What is their experience? What makes them think this business will work? If they sell products, how much do they cost? What is their true market value? What sources of supply are available in your area? What kinds of research have been done? What is the average earnings of active distributors?
3. *What is the start-up fee or what purchases are required?* If the cost is substantial, be careful! The start-up fee in legitimate multi-level companies is generally small (usually for a sales kit sold at or below company cost). Pyramid schemes make all of their profit on signing up new recruits, therefore, the cost of joining is usually high.
4. *If you could be stuck with unsold inventory, beware!* A legitimate company should offer and stick to buy-backs for at least 80% of what you paid.
5. *Consult with others who have had experience with the company and the promoters*. Check to see if any products are actually being sold to consumers and how consumers respond. Pyramid schemes are not concerned with establishing a market through repeat sales to satisfied product users.
6. *Get written copies of all available company literature, including an audited financial statement, and verify all information*. Do not assume that official-looking documents are accurate or complete. Check out the company with your local district attorney, the state general's office (801-530-6601), or the Better Business Bureau (801-892-6009, 24 hours).

When someone offers to make you rich overnight, your best defense is healthy skepticism. If it sounds too good to be true, it probably is!

Utah State University is an affirmative action/equal opportunity employer and educational organization. We offer our programs to persons regardless of race, color, national origin, gender, religion, age, or disability. Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, Robert L. Gilliland, Vice President and Director, Cooperative Extension Service, Utah State University.