

# MULTI-LEVEL MARKETING - A TOOL OF RELATIONSHIP MARKETING

Cristinel CONSTANTIN<sup>1</sup>

**Abstract:** *This paper aims to analyse the opportunity of using multi-level marketing (MLM) as a tool of relationship marketing. The research is firstly based on an analysis regarding the issues about the legality of MLM techniques in the context of EU and US regulation systems. The outcomes of this research stress the main characteristics of legal network marketing and how a person which wants to become independent distributor could avoid the cooperation with an illegal pyramid scheme. The second research is based on a case study at the level of an insurance broker, which emphasizes the benefits that all parties involved in a transaction (broker, distributor and customer) could obtain by using an MLM scheme.*

**Key words:** *multi-level marketing, relationship marketing, insurance sector.*

## 1. Introduction

This paper is about a part of our research done in order to find powerful tools that can strengthen the marketing activities of companies. In our previous research studies we found that the importance of relationship marketing for the successful business is accepted on a large scale in the specialty literature. The need to adopt relationship marketing comes as a result of diversification in customers' requirements, the companies being forced to establish strong relationships with their customers, to maintain them and to create a basis of mutual cooperation in the long term.

Relationship marketing can be implemented in multiple ways through an active involvement of all marketing activities, from the links with the environment factors to a rethinking of all policies and strategies related to the marketing mix.

Starting from these considerations, we focused on the distribution system used by an enterprise, the main objective of our

research being to find better tools of relationship marketing. Among these tools, direct sales and its particular case "Multi-Level Marketing" use the best techniques meant to establish long-term and profitable relationships in spite of higher criticisms from many authorities. The research is based on a case study of the distribution system established by certain insurance brokers in Romania.

## 2. Literature Review

Relationship marketing is defined as building, developing and maintaining strong relationships with customers and other stakeholders in order to obtain a high profitability (Berry, 1983, Grönroos, 1989, 1994, 1996, Hunt, 1994, 1997, Mattsson, 1997). The motivation of consumers for engaging in relational exchanges is the perception that the benefits of engaging in relational exchange with particular firms exceed the costs incurred. Morgan and Hunt(1994) identify "relationship benefits" as a key antecedent for the kind of

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<sup>1</sup> Dept. of Marketing, Turism, Services and International Transactions, *Transilvania* University of Braşov.

relationship commitment that characterizes consumers who engage in relational exchanges. Furthermore, consumers desire relationship partners that they can trust. They do so because a trusted partner reduces the risks associated with relational exchange, because trust is associated with a partner's reliability, integrity, and competence (Hunt, Madhavaram, Arnett 2006). All of these are reasons of customer satisfaction that generate additional benefits at the level of companies, which can also trust their customers and the achievement of their objectives.

When we speak about multi-level marketing (MLM), it can be observed that its techniques are proper for establishing strong relationships inside the distribution channels of a named company. Multi-level marketing (also called network marketing) is a form of direct sales in which independent distributors sell products, usually in their customers' home or by telephone. In theory, distributors can make money not only from their own sales but also from those of the people they recruit (Barett, 2008).

The parent company promotes its products directly to consumers by means of relationship referrals and direct selling. The distributors undertake both selling and promotional activities, so that the company very much cuts its costs dedicated to promotional activities.

Independent distributors develop an active customer base, which buys the company's products, in order to earn a commission or the difference between the wholesale and retail price. Additionally, distributors build their own downline of independent distributors who also build a customer base, thereby expanding the overall organization (Gonzales, 2008).

Typically the downline network of a member grows in a pyramid fashion. In some schemes there is a restriction that one member A can directly appoint only two

members under him (B and C or Right and Left). He can invite further members, but they have to be put under B or C. Thus, the distributor A is forced to help the downline while expanding his own business (Sreekumar, 2007). The network develops in a binomial system (see fig. 1).

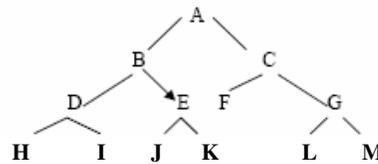


Fig.1. *Example of a downline in binomial system*

In other types of scheme there is no restriction regarding the number of distributors placed on the next level under a named individual. Nevertheless, in order to be promoted on the hierarchical scale, a distributor must have a fixed number (2 or 3) of direct members placed at a maximum of 2 levels below on the named scale. Thus, the promotion is related both to the individual and downline performance.

Distributors earn a commission based on the sales efforts of their organization, which includes their independent sale efforts as well as the leveraged sales efforts of their downline. This arrangement is similar to franchise arrangements where royalties are paid from the sales of individual franchise operations to the franchiser, as well as to an area or region manager. Commissions are paid to multi-level marketing distributors according to the company's compensation plan. There can be multiple levels of people receiving royalties from one person's sales (Gonzales, 2008).

Many distributors fail thinking they can earn rapid profits from their downline, without high investment or hard work. In this respect, Maloney (2006) wrote in its "Business Tips" that "if you are trying to

get rich quick, perhaps the lottery would give better odds; MLM takes real work to be successful”.

### 3. Issues Regarding MLM

Some debates according to many similarities between MLM and Pyramid schemes generated issues at the level of European Union and USA regulatory systems.

Many companies which develop MLM networks promise higher profits to their distributors based on the extra-commission earned from their downline. Other firms do not provide all the information about their products to their customers and distributors, or give false information. All these practices are considered unethical, being classified as “misleading commercial practice”.

A commercial practice is misleading when it contains false information or omits information that the average consumer needs, according to the context, to take an informed transactional decision and thereby causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise [6].

Other criticisms consider MLM as being an aggressive practice, as far as the distributors visit the consumers at their home and try, in various ways, to convince them to buy products that they do not really need. On the other hand, some companies force the distributors to buy high quantities of goods without any possibility for the latter to return the unsold products. Thus, the distributors are forced to buy the products for themselves [4].

A commercial practice shall be regarded as aggressive if, by harassment, coercion, including the use of physical force, or undue influence, it significantly impairs or is likely to significantly impair the average consumer’s freedom of choice with regard

to the product [6].

Multi-level marketing was also subject to debates at the level of the European Union, the European Commission being sponsor of some research programs with the aim to study whether and to what extent it is necessary to have European rules on multi-level marketing. One of these studies emphasized that MLM techniques have been, and still are, criticised for containing elements of the well-known, but usually banned, “pyramid and snowball systems”. This is because multi-level marketing allows, at least in theory, for the erection of an endless ladder of marketing levels [5].

According to the same study, pyramid and snowball systems allow the members of the distribution chain to receive bonuses for recruiting new members of the network or a part of the initial investment made by the new members. There are included in the same category those systems in which a member earns commissions only related to the continuous purchases of the new members introduced by him into the network.

The regulation of illegal pyramid schemes received special attention from USA authorities as well. According to the Federal Trade Commission, in a pyramid scheme participants hope to reap financial rewards well in excess of their investment, based primarily on the fees paid by members of their “downlines”.

Other private organizations proposed various guides for customers, which try to make better distinction between a legitimate MLM plan and a dangerous pyramid scheme. Such a guide is presented by the USA National Consumer League (NCL), which was established to protect and promote social and economic justice for consumers and workers in the United States and abroad (see Table 1).

*Comparisons between MLM and Pyramid schemes*

Table 1

	<b>Multi-Level Marketing plan</b>	<b>Pyramid</b>
<b>Business focus</b>	Sales of products and services to end-users (NOT other distributors)	Recruiting new members.
<b>Profits</b>	Primarily based on the sales of products and services by the distributor. Perhaps some percentage of income from sales by downline recruits.	Primarily membership fees paid by new recruits or “bonuses” for meeting recruitment goals.
<b>Products or services for sale</b>	Household goods or services that consumers typically use in everyday life. Goods and services are priced competitively with traditional retail outlets.	Often a thinly-veiled and poorly-made “miracle” product or service that few consumers want or need. Merchandise is typically priced well above comparable products sold in retail stores.
<b>Start-up costs</b>	Low or none at all.	Often involving recurring “membership” fees or expensive “educational,” “training,” or “advertising” materials that can easily be found free of charge elsewhere.
<b>Support system</b>	Low-pressure, eager to answer questions about the business and provide detailed information in writing upon request, such as a business and marketing plan	High pressure, with a constant focus on recruiting new members of the scheme. Hard to reach when questions arise.
<b>Employee/customer references</b>	Eager to provide references who provide honest evaluations of the viability of the MLM plan and the work necessary to succeed.	Unwilling or unable to provide references or only provides references who themselves attempt to recruit a caller.
<b>Sales pitch</b>	Provides detailed information about the work involved. Offers no promise of easy riches. Does not use high-pressure sales tactics.	Involves promises of large profits with minimal work, often in high-pressure seminar environments. Uses phrases like “limited time offer,” “can’t miss opportunity,” and “guaranteed income.”
<b>Info available?</b>	Has a good report with the consumer protection agencies and is registered with the local Chamber of Commerce.	Not registered with the local Chamber of Commerce. Information about the company is scarce or limited to a Web site.
<b>Getting out of the business</b>	Easily accomplished and accompanied by a reasonable merchandise buy-back program	Difficult, with high-pressure tactics used to keep participants in the scheme, possibly accompanied by pitches to spend more money on “training” to improve performance.
<b>How long the business will last</b>	Sustainable, based on repeat sales of products and services	Doomed to collapse
<b>How likely you’ll profit</b>	Profits are based on time and effort devoted to selling goods or services to consumers.	The vast majority of participants lose money.
<b>The bottom line</b>	<b>It’s a legal business opportunity that may or may not be a good fit for you.</b>	<b>It’s illegal. Don’t waste your money.</b>

Source: [www.fraud.org](http://www.fraud.org) – A guide from NCL’s Fraud Center

In conclusion, beyond the issues regarding the legality of MLM networks, both at the level of the USA and the EU it is recognised that those plans managed according to business ethics and respect regarding customers and members of the distribution

network could be considered correct and legal commercial practices.

**4. Applications of MLM on the Insurance Market**

Our research is based on a case study of the distribution system established by several Romanian brokers that operate in the insurance sector. The main objective of this research was to identify the importance of MLM schemes for brokerage activities and their influences on the implementation of relationship marketing.

Insurance products are in essence special services regarding the risk transfer from the service beneficiary towards an insurance company, in exchange for an amount of money, called insurance premium.

Due to the fact that such services, as the majority of services, are not tangible and particularly involve a significant money investment that is usually not recovered if the risk does not happen, the process of selling insurance services is quite difficult.

There is a well known joke among insurance sellers, which states that “nobody goes to a supermarket (or other shops) in

order to buy an insurance policy”. In this context, the insurer agent has to contact the potential customers, to identify their necessities and to offer them insurance programs that better fit their needs. Thus, a strong relationship is developed between the agent and customer, which often exists before the transaction, as the insurance sellers seek their prospects firstly among their acquaintances and relatives.

Taking into consideration the above mentioned particularities, many brokerage companies that deal in the insurance sector establish multi-level marketing networks that expand very fast and cover a large part of the national territory.

In Romania, there are insurance brokers that record high turnovers using MLM as the main distribution system. Such companies, like Kundenbroker, Eurobrokers Group, Destine Broker, MaxyGo are situated among the biggest brokers on the local market. Their networks contain 10-12 levels with specific tasks inside the sale process. Such a network is presented in Fig. 2.

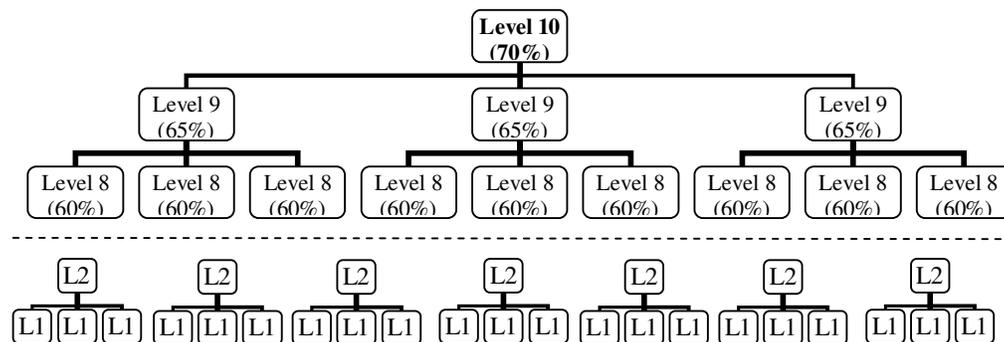


Fig.2. An example of MLM network used by insurance brokers

In order to be promoted to a higher level inside such a network, a distributor must have at least 3 direct distributors on the next level below. In addition, all his downline should account for a specified number of points according to the total sales of insurance policies. Thus, a distributor has to work in order to keep all the time a high level of sales

and to develop his downline so as to have at least 3 direct members at a maximum of 2 levels below him. As presented in Fig. 2, the distributors situated on the 9<sup>th</sup> level could be promoted to the 10<sup>th</sup> level, on condition they have enough points accumulated from insurance sales.

The earning of every distributor has two components: a direct commission from his direct sales and an extra-commission from the sales made by his downline. The commission rate depends on the level of network, being calculated as a ratio from the total income collected by the broker for the insurance sold by a downline structure. For instance, a distributor situated on the 10<sup>th</sup> level earns 70% of the total commission paid by the insurer for the sales made by himself and his downline. This commission is cashed entirely for his personal sales and from his downline, the distributor is entitled to receive the difference between the levels' ratio. In this respect, a member of the network from the 10<sup>th</sup> level will receive 5% of all the commission generated by one of his direct distributors from the 9<sup>th</sup> level together with his entire downline.

A distributor situated on the 10<sup>th</sup> level could not receive an extra-commission from a direct distributor promoted on the same level, but he can receive a bonus according to the total sales of that downline.

Such a network grows very fast, requiring a huge effort to manage all the structures and the entire selling process. For example, a distributor from the 10<sup>th</sup> level, which has a downline with only 3 direct members at every level below, records  $3^1+3^2+3^3+\dots+3^9=29523$  members in its own structure. In order to keep this amount of people under control, every distributor which has a downline is in charge with the management of their direct and indirect distributors, being entitled to receive the extra-commission for these efforts.

### 5. Conclusions

As a tool of relationship marketing, the development of a downline for every member of the distribution channel leads to a rapid expansion into the market, with high profits for the promotional activity. The company should invest almost nothing in promotional campaigns, its products being promoted using a "word of mouth" technique. This technique generates a high level of confidence among consumers as the promoters are their friends or relatives.

One of the most important reasons to join an MLM network is that firstly the distributor likes the products that are going to sell. Additionally, the product has to be consumable and with a good quality-price ratio as prerequisites for customers to make repeated purchases. We can find such a case in the insurance sector, where the representatives of brokers could offer to their customers the best solution for their needs, taking into account both the price and the main characteristics of the insurance. This situation is possible as a result of the cooperation between the broker and more insurance companies.

Taking into consideration all the above mentioned, MLM could be considered a powerful tool of relationship marketing.

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