

## KITTY PARTY AND MLMs

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*{ After the Chit funds, vanishing companies, tree-plantations, cooperative banks we are now likely to see the next wave of scams in the form of Pyramid or multi-level marketing schemes. Our Lead article in this issue tells you in an entertaining manner about the pitfalls in these otherwise brilliant schemes. A draft Act is pending consideration with the AP State Home Dept. to tackle this menace. - Ed}*

It was a kitty party of ladies and nearly 8-10 ladies, most of them housewives had gathered at Mrs. Radhika's house. Since it was June, the topics discussed were school reopening and summer vacations.

Mrs. Radhika :In which college did you admit your son?

Mrs. Ramya :I admitted him in Sri Chaitanya College

Radhika: How much are the fees?

Ramya :It cost us more than 50,000/-. We paid Rs. 20000/ at the time of admission and every month we have to pay Rs.3000/.

Radhika: That's quite a lot

Ramya: Yes, and this has upset our monthly savings and due to the water crisis, we are spending an additional amount of Rs. 1000/p.m. on maintenance charges.

Radhika: Yes, these days education has become very dear unlike earlier days. For my kid who is in class V, I am spending nearly Rs.2000/- p.m.

Ramya: Unless both wife & husband are employed it is becoming difficult to meet both ends.

At this juncture, Sujatha joins the conversation, she had just returned from a summer holiday at Singapore.

Sujatha :Our holiday in Singapore was great and the roads, buildings and gardens are ...

Radhika: How long did you stay?

Sujatha :One week.

Ramya How much did the trip cost?

Sujatha :It cost us nearly 1,00,000/- and I earned this entire amount in this year through Multi Level Marketing (MLM) of 'Bigway' herbal products

Radhika &  
Ramya: What is Multi Level Marketing?

Sujatha: Multi Level Marketing is a revolutionary concept of marketing which has become very popular in USA/Europe, In this scheme products are sold through contacts and not through stores, thereby eliminating the overheads and distributor and retailer margins and these margins are passed on to the actual end users.

Radhika :It sounds interesting.

Ramya: Could you elaborate?  
Sujatha takes out some brochures and gives them to Radhika and Ramya.

Radhika :I have not seen these products in any of the stores I visit.

Sujatha: No, they are not available in stores. Users like me sell them. I have used these products and found them very good. You can also become a member of Bigway if you want to become a dealer (reseller) like me.

Radhika: How much does this toothpaste cost?

Sujatha: Rs.250/-

Ramya: It's much costlier than the Colgate, which costs only 70/-.

Sujatha :It's in a concentrated form and it's made of herbs and is good for teeth unlike ordinary pastes, which are made of synthetic chemicals whose residue is harmful.

Radhika: How much is the detergent?

Sujatha: Rs.600/-litre, which is a concentrated mix.

Ramya: That's too high compared to surf, which is available for 120/-

Ramya: Any discount?

Sujatha: Yes, if you become a member of Bigway?

Radhika: How does one become a member?

Sujata: By buying the Bigway kit, which consists of many cosmetic products.

Ramya: How much is the kit?

Sujata: Kit costs Rs.10,000/- and gives you free membership of Bigway.

Radhika: What is the advantage of being a member?

Sujata: You are eligible to act as a reseller of Bigway products, for which you get a commission of 5%-15% on products sold by you.

Radhika: But the products are far costlier than the ones available in stores.

Sujata: Yes, but you have the health advantage by using 'herbal' products and membership in Bigway could entail you to a monthly income of 25,000/- to 1,00,000 per month.

Ramya: How can that be possible unless I sell 5 to 20 lacs worth products every month, which is not an easy task?

Sujata: That's the beauty of these MLMs. You don't have to sell 5 lacs of products every month. All you have to do is sell 3 kits each costing Rs.10,000/-.

Radhika: By selling 3 kits I would be making only Rs.1,500/-.

Sujata: Let me complete dear. You make more money as you get commission on sales made by your down line.

Ramya: What does down line mean?

Sujata: Down line is the person who has brought kits from you and they are known as your 1st generation down line. Those who buy from your first generation are known as your second generation down line and so on. As your down line increases your compensation/commission keeps increasing. You make more money through sales made by your down line than on what you sold directly.

Sujata takes out a paper and explains as to how commissions are given at different levels.

Sujata :On selling three kits you become member of Silver Club, which entails you to a commission of 7.5%. On these three members (your 1st down line) selling three kits each you become member of Golden Club, which entails you to a commission of 10%. On these nine members (2nd generation down line) selling three kits each you become member of Platinum Club, which entails you a commission of 10%. On these 27 members (3rd generation) selling three kits you become member of Diamond Club, which entails you a commission of 15%. In this way as your down line progresses you become member of International Gold Club and International Platinum Club and International Diamond Club and you get commissions on all sales made by you or your down line and this could run into lacs.

Sujata explains through a sketch how much a person could earn by the time he is a member of Diamond Club.

	Rs.
Member	3 x 500 = 1500
Silver Club	9 x 750 = 6750
Gold Club	27 x 1000 = 27000
Platinum Club	81 x 1000 = 81000
Diamond Club	243 x 1500 = 364500
Total	= 480750

Ramya: What if you enroll more than 3 members.

Sujatha: This is the income you will make if you enroll 3 members and from the down line of these 3 members. For every 3 additional members enrolled by you, you will be making an equivalent amount indicated and sky only is the limit for your income.

Radhika: How did you know of this plan?

Sujatha: Through a friend of my sister, who stays in USA and she is making lots of money. In fact MLM is otherwise known as Making Lots of Money.

Ramya: Is it legal?

Sujatha :It's perfectly legal and is accepted in advanced countries of US/Europe etc. Some retired Supreme Court judges have also opined that this scheme doesn't come under any illegal activities.

Radhika & Ramya: But initial investment seems high we will consult our husbands and let you know.

Ramya excitedly tells her husband Prakash about Multilevel Marketing.

:I can also earn Rs. 25000 – 1.0 - lac per month and please give me Rs. 10,000/- for buying cosmetics for the entire year.

Prakash: Do you think it's so easy to make money? There is some catch in this scheme, any way I will discuss with our bank's legal adviser before taking a decision.

Prakash on the next day at office asks their legal officer Ramesh about MLM

Ramesh: You will go to jail, as these types of marketing plans are nothing but camouflaged money circulation schemes and are known as 'Ponzi' or 'Pyramid' schemes in US/ Europe.

In the Internet you can find lots of websites campaigning against multilevel marketing. People who have lost their hard earned money in such schemes have started these sites. Thank God! In India, money circulation schemes are banned under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978. Section 2 (c) of the Prize Chits and Money Circulation Schemes (Banning) Act, 1978 defines a money circulation scheme as, any scheme, by whatever name called, for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions.

Prakash: Do you mean to say that making of quick or easy money is an offence? Then our lawyers in the higher Courts who charge astronomical amounts for one appearance and doctors who collect a fortune for one operation will all be put in jail.

- Ramesh :The Supreme Court had examined this question in *State of West Bengal Vs Swapan Kumar* AIR 1982 SC 949 while discussing the definition of 'money circulation scheme' and has rearranged the definition for the sake of clarity as: "any scheme, (a) for the making of quick or easy money or (b) for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions." The court has clearly explained the ingredients, which need to be fulfilled for a scheme to become a money circulation scheme. Any scheme for the making of quick or easy money contingent upon the enrolment of members into the scheme is a money circulation scheme. Similarly, any scheme in which money or any valuable thing is received and a promise is made to return the money on the event of enrolling members into the scheme is also a money circulation scheme.
- Prakash :But such a law will be contrary to the freedom to carry on any occupation, trade or business as enshrined in Article 19 (I) (g) of the Constitution of India.
- Ramesh :The constitutionality of the provision has already been examined and upheld by the Apex Court in *Srinivasa Enterprises Vs Union of India* AIR 1981 504 SC. Justice Krishna Iyer in his usual flair for writing unforgettable quotes wrote: "Can you save moths from the fire except by putting out the fatal glow?". The Supreme Court has further stated that these types of schemes are prejudicial to the public interest and also adversely affect the efficacy of fiscal and monetary policy. While interpreting the definition of money circulation scheme, one has to look at the mischief, which the legislation has sought to remedy. The James Raj Committee constituted by the Reserve Bank of India in the year 1974 proposed the legislation. After studying the various schemes which were floated in the country during that time and taking into consideration the impact of such schemes on the economy, the Committee after extensive research and analysis have suggested for a ban on Prize chit and other schemes which were causing a great loss to the economy. A large amount of money that can be used for industrial and developmental activities are wasted on such illegal schemes.
- Prakash :Which agency is entrusted with the powers to take action against such illegal activities?
- Ramesh :All the offences under the Act are Cognizable. Under Section 7 of the Act, a police officer not below the rank of an officer in charge of a police station can enter, if necessary by force, by day or night, any premises which he has reason to suspect, are being used for purposes of conducting or promoting any money circulation scheme. He can search such premises and take into custody any person and produce before a Judicial Magistrate all such persons who have been concerned with the use of such premises connected with the promotion or conduct of any money circulation scheme. He can seize all things found in the premises, which are intended to be used, or reasonably suspected to have been used, in connection with any money circulation scheme. Under Section 8 of the Act the State Government can forfeit any newspaper or publication containing any material connected with the promotion or conduct of money circulation scheme.

Prakash :I agree with you that money circulation schemes are banned under the Prize Chits and Money Circulation Schemes (Banning) Act, 1978, but in the scheme of the company we are discussing there is a sale taking place with every enrolment. So I think it is a genuine commercial transaction and not money circulation.

Ramesh :For considering whether a scheme is a money circulation scheme or not, we must analyze the scheme as a whole. In the present scheme, a person is lured into the scheme and made to buy some products by promising him that he will be getting huge amounts of money in return. Moreover, the money he gets in return is linked to the number of persons he or his agents enroll rather than the number of independent sale of the product. Sometimes, a person is forced to buy products at exorbitant rates, which are many times higher than market rates of similar competing products on the promise that he will be getting huge returns. Then he is left with no option but to enroll more members into the scheme and recover the money already paid to the company, at an exorbitant price to the product, in the guise of commission. The thrust of the brochures and business plans issued by such companies will be on making money by enrolling more members and not on the sale of products. It is thus clear that the plan uses the lure for money as the bait to attract people into the plan and the sale of products is of secondary or no importance at all.

Prakash :It is really a camouflage. But why any person will go to jail for enrolling as a member and that too when he is not the promoter?

Ramesh :Under Section 3 of the said Act, no person shall promote or conduct any money circulation scheme, or enroll as a member to any such scheme, or participate in it otherwise, or receive or remit any money in pursuance of such scheme. So even a person enrolling himself as a member or participating in the scheme is an offender. The prescribed punishment under Section 4 is imprisonment for a term, which may extend to three years, or with fine, which may extend to five thousand rupees, or with both. A minimum punishment to the extent of imprisonment of not less than one year and fine not less than one thousand rupees have been provided. This shows the gravity of the offence. Then again printing, publishing, selling or distributing any materials relating to such schemes have been made punishable with imprisonment for term, which may extend to two years, or with fine which may extend to three thousand rupees, or with both, under Section 5 of the said Act. Here also a minimum punishment to the tune of imprisonment not less than one year and/or fine not less than one thousand rupees have been provided.

Prakash :But she said that some of the Companies in USA are doing very well and having a Turnover of \$ 5 billion and have become multinational by spreading all over the world.

Ramesh :Yeah, they are able to survive with the help of lacunae in laws in those countries and also by spending heavily on battery of lawyers. Many Multi Level Marketing Companies quote the example of the famous Amway case of 1978 wherein court ruled in favor of Amway. But there is much untold side of the story in that case . Amway could get away by promising to fulfill three conditions, which are known as Amway Safeguards.

- (1) Buy back policy : It will buy back its products from the customers who are not satisfied
- (2) 70 % Rule : At least 70% of its sales are to end-users and not to its members/distributors.
- (3) Rule of 10 : Each distributor shall have at least 10 retail sales every month

In reality these 3 conditions are never fulfilled and in the recent famous Omnitron case courts ruled against Multi Level Marketing, which has turned the tables against Multi Level Marketing. Dozens of Multi Level Marketing Companies have been shut down and made to pay heavy penalties / compensation to its victims by FTC. Some examples are Sky biz,.

Prakash :How would one differentiate from an illegal money circulation scheme from a genuine product based Multilevel Marketing Scheme which sells products and doesn't charge enrolment fees.

Ramesh :To know if a Scheme is a Money circulation Scheme disguised as a Multilevel Marketing Scheme one has to check for the following characteristics and presence of any one of these is sufficient to identify it to be product based money circulation scheme.

**1. A chaining hierarchy of levels of distributors— more than is functionally justified—is recruited without area limits, which leads to extreme leverage and perceived saturation in the marketplace.**

If any MLM Scheme has more levels of distributors than required functionally it can be suspected to be a MONEY CIRCULATION SCHEMES. Even a big multinational like Hindustan Levers doesn't have more than 4 or 5 levels of distributors in a large country like India. If a MLM scheme has 5 and more levels of distributors than it's likely to be MONEY CIRCULATION SCHEMES disguised as MLM.

No territorial protection to prevent saturation

If reasonable territorial protection is not offered to participants in a given area, the program will ultimately collapse from market saturation. Recruiters promote the illusion of an ever-expanding market and of the potential for large payouts for virtually all-new recruits.

The inherent problem with any Multi Level Marketing is market saturation and that is the reason the biggest player among Multi Level Marketing like Amway have shut down operations in N.America and shifted to 3rd world countries like India, which have tremendous market potential.

2.Relative vertical equality (RVE) in distributor compensation leads to an emphasis on recruiting and to extreme horizontal inequality (EHI) over the entire network of distributors.

Normally any company marketing its products through a chain of distributors pays commissions in the descending order i.e., the frontline distributor (Retailer) receives higher % of commission on sales than the middle level distributor and the top level distributor receives much less % of commission on sales than the middle level distributor i.e., if a frontline distributor receives 10% then the top level person will be receiving 1-2% . This pattern of payment of commissions in descending order is followed to ensure that the frontline distributor who has less sales volume has good returns. If in any MLM Scheme the distributor at frontline receives less or equal commission than the distributor at higher levels than it can be suspected to be a Money Circulation Schemes disguised as MLM. This feature is also known as RVE ( Relative Vertical Equality) in payouts to distributors at different levels. This RVE results in EHI ( Extreme Horizontal Inequality ) i.e., majority of distributors (>90%) do not make any money while a microscopic minority (< 1%) at the top receives most of the payout money while a few 2-5% make just enough to keep them hoping for a better day and thereby sustain the company.

This can be verified by asking the MLM companies to furnish the payments percentile wise **which should include the inactive members too**. If majority are not receiving any amounts and only a microscopic minority receive major portion of the payout then we can conclude that the scheme is nothing but a Money Circulation Scheme disguised as a MLM.

3. Significant purchase or recruiting quotas are required (or incentives offered) to qualify for increasing bonus levels or purchasing discounts in an ascending hierarchy of payout levels. This is referred to as the “pay to play” feature of a pyramid scheme.

While this need not be an essential feature of a Money circulation Schemes, this is a prominent feature in enduring Schemes. “Successful” (in terms of lasting more than a year or two) MLM’s make it difficult for a distributor to be satisfied at any level of sales already accomplished. Higher bonus levels for recruiting more distributors or for moving more products keeps success-motivated participants on a continual treadmill. As a result, they often purchase more than they need for themselves or than they can realistically sell, especially at the excessive retail prices suggested for many MLM products.

Ramesh :Do you still want to join the scheme?

Prakash :No. Thank you for saving my life! But for you, I would have gone to jail. I will build my world with hard earned money and not easy money.