

WHY MLM COMPANIES FAIL

By: D. Jack Smith

MLM Attorney

One of the most frequently asked questions at executive symposia, conventions, seminars and other gatherings of MLM executives and distributors is: “In your observations, Mr. Smith, what are the primary causes for the failure of MLM companies?”

By way of response, I usually state first of all that the failure rate for our industry does not seem to be any greater than the failure rate for all other new nonfranchised businesses. It seems to be a commonly accepted fact that 90% of all nonfranchised restaurants that open will not be in business 5 years later. No one uses this statistic in order to disparage the restaurant industry or to advocate that no new nonfranchised restaurants ever be allowed to open in the United States.

From my experience with our industry I would be very, very surprised if the failure rate of new MLM companies even approached that of nonfranchised restaurants.

Nevertheless it is common knowledge that many of our new companies simply will not survive over the long term.

There are a number of reasons for this.

Ironically, I believe that one of the greatest attractions and greatest strengths of the MLM industry is also one of its greatest weaknesses. I am

referring to what is also known as “ease of entry.”

In other words, it seems to be far, far easier to launch a company which can soon be nationwide in the MLM industry than any other industry with which I am familiar. The relatively low capital requirements and demands for technical management expertise permit virtually any average citizen to start an MLM company. I have personally observed one of the most dynamic growth companies spread nationwide almost over night after an extremely humble beginning with only \$5,000 in borrowed capital.

One of the “glories” and positive features of our industry is that it is truly the last frontier and the final hope of the “little guy”. In MLM it is literally possible for dreams to come true and for people who could never afford to capitalize and operate a significantly strong, “traditional” national growth company to go into the MLM industry with a minimum amount of capital and business experience, make an explosive success and create incomes for thousands of Americans who are willing to work.

It is common knowledge that to purchase a McDonalds franchise and to see it through to a proper opening costs at least one million dollars. The franchise industry has simply grown out of reach of the average citizen.

However, this same “ease of entry” also represents a significant weakness of MLM in that because it is the “last frontier”, anyone regardless of financial strength or business acumen or experience, can set up and launch a multi level marketing company.

If I had to pick a primary reason for MLM company failure it would

indirectly be attributed to this “ease of entry”. In other words, unfortunately, many of our companies are begun with an unrealistically small amount of capital, much ambition and zeal, but with little management background, education, training, skill, and experience. It has been my experience that even where a company is successfully launched with these inherent weaknesses, without an infusion of additional capital and/or management talent sooner or later these weaknesses will take their toll and the company may very well fail solely because of them.

Proper management can successfully sell only moderately exciting and glamorous products and can manage personnel, cash flow, production, distribution, credit and debt. Inadequately management over time can not realistically hope to take advantage of even the most exciting products because of the lack of organizational skills.

For this reason I put “poor product package” as the second (not the first) major cause of MLM business failures.

Thirdly, it has been my experience that unexpected explosive growth can place demands on management and its available cash flow and production facilities causing delays in product delivery and commission check mailings. Delay and chaos in the home office quickly translate into disillusioned and disgruntled distributors who will drop out of the same organization and perhaps even file formal or informal complaints with various regulatory authorities.

This leads to what, in my judgment is the last major cause of MLM company failure and that is the oppressive financial costs and drain on

management energy and time in resisting attacks by various regulatory agencies. Since many of our companies are started with meager resources, a legal challenge by one or more regulatory agencies while the company is in its infancy may (without regard to the merit or lack of merit of the regulatory challenge) result in the company's premature death.

Occasionally I have seen what I perceive to be unfair and wrongful legal challenges by inexperienced, unknowledgeable and overzealous regulatory personnel result in overburdening a new company's ability to resist, forcing it to take Chapter 11 or Chapter 7 Bankruptcy or informal business liquidation.

I realize that, from the outside, many regulatory authorities have no way of knowing management's motives or intentions and, as I have said before, 99% of all the personnel with whom our office has dealt have been sincere and have attempted to do the right and proper thing by all concerned.

It is simply an unfortunate fact of life, however, that much injustice occurs because of precipitate and ill informed attacks on new MLM companies. Because of the Attorney General "grapevine", these attacks have some tendency to "domino" in effect regardless of the merit or lack of merit of the initial regulatory challenge.

It is my feeling that a worthy MLM Attorney will always contact the proper regulatory authorities in advance to point out the features of a company marketing plan which make it in compliance and to make himself or herself available to answer questions and erase doubts prior to the company's engaging in business in that particular jurisdiction.

In summary , the reasons for MLM business failure include all reasons ordinary businesses fail plus certain others which are unique to our industry such as ease of entry – which permits some of our companies to begin business with an underestimate of realistic capital requirements and lack of appreciation of the genuine level of management skills required to make a company survive and grow solidly towards becoming national in scope.

Additionally, the nature of our industry can sometimes result in dramatic swings in growth and decline in sales. Where management has not cautiously planned the territories and the timetable for entry it can be suddenly engulfed by a flood of success it is unprepared to handle and, sometimes, by sudden declines in its growth curve if something exists in its marketing plan to cause disappointment among its distributors and an unpredictable drop in sales.

Lastly, the nature of our industry and its superficial resemblance to certain technical statutory violations when the observer is unknowledgeable can lead to unwarranted regulatory attacks which can be burdensome to the point of causing total company failure.

Because the MLM industry does represent the “last frontier” in the economic world, management should constantly aware of the possible failure facts and determined at all costs to achieve stable and controlled sales growth which will not overtax the new company’s ability to perform.