

## **Why every entrepreneur should have a network marketing business**

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It has happened to most of us. We get a phone call or a visit from someone who wants to invite us to a meeting, either at a hotel or a house, but the reason given is vague.

If we actually take the time to show up what we find is a presentation of a business opportunity offered by a promoters of network marketing company, where promises are made to make us rich if we just take the time to show the opportunity to our family, friends and a few others. Often the opportunity revolves around products such as vitamins, minerals, juices, and cosmetics.

Unfortunately, many people have been burned by such business opportunities. In some cases, it is because the business opportunity was a scam – an illegal pyramid where fees had to be paid for nothing in return. In other cases, it is because the products were bad or defective, or because it was necessary to buy huge volumes of inventory. In yet other cases, it was there was more attention paid to buying books, tapes and seminar tickets offered by the promoters, than pursuing the underlying business opportunity.

As a consequence, many people have incurred huge financial losses, and the promoters have earned a bad reputation for the concept of network marketing.

Maybe the biggest reason why people lose money is because, assuming that the system is legitimately, it is a business that requires the same types of skills as any other type of business concept, and most people are unprepared for that.

However, if done legitimately, network marketing is a great business model, and for an entrepreneur, pursuing a network marketing business hones the same marketing and selling skills that are required in any business. A network marketing business can also provide a second source of income that can help supplement income streams for early stage entrepreneurial businesses, which often yield nothing for many years.

In this article, I will discuss:

1. The mechanics of network marketing
2. The benefits of network marketing to entrepreneurs
3. What kind of network marketing business to pursue
4. How to get started

### ***The mechanics of network marketing***

In its simplest form, network marketing is a business model where manufacturers distribute their products through a network of independent marketing executives. This model is an alternative to the “traditional” model where products are distributed through a network of wholesalers and retailers.

In the network marketing model, sales are generated by word-of-mouth, with little or no advertising. In the traditional model, the manufacturers and retailers may invest large amounts of money in advertising.

In the network marketing model, the independent marketing executive usually works from home or a small office. In the traditional model, there is usually a large fixed cost in the retail outlet.

In the network marketing model, the independent marketing executive is a customer of the manufacturer, and enrolls others to be customers. In some systems the independent marketing executive also enrolls others to be independent marketing executives, who in turn enroll others to be customers and independent marketing executives and so on. In the traditional model, customers visit retail facility.

In the network marketing model, the customer either buys directly from the manufacturer, or from the independent marketing executive. In the latter, case the independent marketing executive may have to carry inventory.

In the network marketing model, customers may become members, and place orders on a consistent basis at an inside price, ensuring some predictability of sales. Customers may also buy directly from the independent marketing executive, usually at a retail price, with no commitment to buy on a consistent basis. In the traditional model, predictability of sales is a function of customer loyalty. If customers are not loyal to the products or services or the business that sells them, they will either not buy them at all, or will buy them from elsewhere.

There are many different forms of network marketing model but they all have some common characteristics.

The simplest form is the referral model, where an independent marketing executive refers a customer to the manufacturer in exchange for commissions based upon a percentage of revenue or gross profit. An extension to this model is where the independent marketing executive can also enroll other independent marketing executives, and receive additional bonuses for doing so.

A more complicated form is the “multi-level” model, where each independent marketing executive establishes an independent business of customers and marketing executives, and products “flow” through the various levels, regardless of whether they are shipped directly by the manufacturer or not. Hence, the “multi-level” model may require large volumes of inventory.

The differences are subtle – in the referral model, the independent marketing executive focuses primarily on the products and secondarily on the business opportunity, since without products there are no referrals. In the multi-level model, the independent marketing executive focuses primarily on the business opportunity and secondarily on the products. For this reason, many multi-level systems have run into problems because the products are more expensive and/or poorer quality than “over-the-counter” equivalents.

In both cases the compensation plan is a pyramid. The pyramid compensation plan often creates confusion with illegal pyramids.

In a pyramid compensation plan, the independent marketing executive at the top earns commissions from the independent marketing executives below. In all cases, the commissions are based upon products sold and promotional activities, but never from membership fees.

In some systems, the higher the executive in the pyramid, the higher the compensation earned. In other systems, that is not necessarily the case. Such compensation plans follow plans in traditional sales organizations and in the corporate world in general.

In an illegal pyramid, the independent marketing executive earns income from membership fees, and usually there is no product.

For a pyramid system to be legal, a product and/or a service has to be delivered to a customer.

Network marketing is similar to franchising, in as much as the network marketing company allows the independent marketing executives to represent its products with specific guidelines using principles of duplication.

Regardless of the negative stigma which has been caused by illegal pyramids and other bad business practices, network marketing is not only a bona fide business model, but an excellent way to learn many of the techniques required to build a traditional business.

In fact, one the principal reasons why independent marketing executives fail is because they were told that the concept was a get rich quick scheme, but did not realize that they would have to be business people. A negative consequence is the expense incurred to generate a small (or potentially no) volume of sales. However, no business venture is without risk, so common sense business principles apply.

Some independent marketing executives fail because of the fear of starting, either because they are afraid of rejection, or they have doubts, such as “what will people think of them,” or “are the products really effective,” or “I don’t want to make money off of my friends.”

With respect to the last point, someone is making money from everybody who buys.

In some cases, a network marketing business can be simpler than a traditional business, because much of the work is done by the manufacturer. However, as with any business, the proper mindset and actions are required, and the independent executive must understand the Federal, state and local tax laws, business licensing laws and other laws that may apply to their situation.

Successful independent marketing executives earn residual income from large numbers of orders for products on an ongoing basis from those customers that they have personally referred and from customers of the independent marketing executives that they have

referred. The larger the volume and size of product orders, and the more frequently the orders are made, the greater the opportunity for a large income.

The economics of network marketing business models versus traditional business models are quite different.

In a traditional model, the manufacturer sells to a wholesaler/distributor who sells to a retailer through the use of agents, brokers, jobbers, representatives and other intermediaries.

Hence there are multiple “middlemen,” all of whom either mark-up the product price or are paid commissions. The price paid by the end consumer may be multiple times the original cost because of all of the intermediaries. There are other factors built into the end price to the customer such as the cost of carrying the inventory if it sits on the shelf for a long time, and the transportation costs for shipping the product, in addition to allowance for operating expenses and net profits.

Because some industries, such as consumer products are highly competitive, there will be pressures on manufacturers to keep their product costs low through the use of poorer quality ingredients, but spend large amounts of money on brand awareness and advertising to differentiate their products from those of competitors. The end consumer may never be aware of the use of poor quality ingredients – if the brand is well promoted and successful, there can be an underlying assumption in the consumers’ minds that the product is good.

In the network marketing model, most of the expenses to generate sales are borne in the field by independent marketing executives, which may or may not be properly identified and classified or not. The advertising expense that would otherwise be incurred by the manufacturer can be redirected to higher quality ingredients, referral fee commissions, lower product prices to customers, or higher profits. The lack of middlemen should ensure that the product prices are lower – however, shipping costs may offset some savings.

If the prices of the products offered in a network marketing business are higher than in a traditional system, but there is no demonstrable increase in quality, then the system should be suspect.

Therefore an “acid test” for a network marketing system is whether the quality of the products justifies the price – if the answer is “no,” then the system should be avoided.

As with any business, the start-up costs may be high relative to the early returns. Therefore, it is important to limit early “investments” (expenses) until there has been some success.

However, because of the residual income effect, the economic model for the network marketing model is different from the traditional model.

The commissions in the network marketing model are usually based on residual income from customer members who commit to buying products on an ongoing basis. The assumption is that as members, the customers will be loyal to the business.

Consistent sales in the traditional model come from awareness and loyalty – the lower the loyalty, the higher the volume of “casual” or occasional customers required.

Network marketing businesses work better when there is an ongoing need for products. In traditional businesses, some sales are generated from “wants” versus “needs,” often on an impulse basis.

Residual income can only be earned over time from needs.

So in the economic model: the lower the loyalty, the shorter the term of the benefit of the advertising and promotional expenses.

For example, let’s assume that a retailer pays \$200 for an advertising program that generates additional gross profits of \$20 per day – he would break even after 10 days. After that he would have increased his net profit by \$20 per day, assuming that there are no other additional costs and expenses. However, unless the additional customers refer other customers the additional profit will eventually go away. If the life of a customer relationship is three years, then the profit would erode from the fourth year onward. Assuming 363 days of operations per year for three years, then the total additional profit would be \$19,800 to the business over three years.

However, let’s also assume that a network marketing executive pays \$200 for a hotel meeting program that generates additional marketing executives, from whom the combined referral commissions for their purchases and their referrals is the equivalent of \$20 per day, regardless of which independent marketing executives remain in the system or leave. Then in this case, the \$20 residual income per day is perpetual. Assuming 365 days per year, \$20 residual income per day is equivalent to \$7,300 interest earned per annum on an “investment” of \$121,667 at a 6% simple interest rate.

So is the program a \$200 expense that generates a net incremental profit of \$20,000 to a traditional retailer, or is it the equivalent of an investment of a \$121, 667?

Is there a catch? Not really, although one may have to take into consideration the cost of time. In the early months and years, the independent marketing executive may have to spend a significant amount of time providing an environment within which to motivate others to make referrals. Let’s assume that the executive spends 16 hours a week for three years in this activity, but after this point, the organization is operating independently. If we value the cost of the executives time at \$25 per hour, then the total cost of this time would be \$62,400 – about half of the “invested” amount. The \$25 figure is real only if the executive could earn that amount somewhere else.

In reality, we never know the actual costs, expenses and benefits, because the accounting systems cannot capture all of the behaviors over time.

So it would appear that the network marketing model is a more profitable model than the traditional model over the long haul for both the manufacturers and the independent marketing executives.

The quicker and larger the network can be built, the more the manufacturer and the independent executives will benefit.

However, to build a sustainable network marketing business requires effort and resilience to overcome the rejections and the doubt.

### ***The benefits of network marketing to entrepreneurs***

The benefits of network marketing to entrepreneurs are simple – to develop skills in persuading prospects to become customers and potentially independent marketing executives.

To do this successfully requires a set of leadership and marketing and sales skills that go further than the entrepreneurial skills of innovating products. Whereas many entrepreneurs have great product development and process development skills (left-brained activities); they need people based skills to convert prospects to customers (right-brained activities.)

Hence developing skills in building a network marketing business may round out the skill set of a would-be entrepreneur.

The leadership skills include the ability to:

- Be self-motivated
- Be aspirational (often called dreaming)
- Be inspirational (to attract followers)
- Be able to establish an environment for team motivation
- Be able to negotiate – which means being able to communicate so as to inform, convince and persuade prospects to become customers, and to create a win/win situation (depending upon how the network marketing system itself actually works)
- Be able to provide training to enable the system to duplicate through newly enrolled independent marketing executives

The marketing and sales skills include the ability to:

- Build contact lists of prospects
- Approach prospects to set appointments
- Present the products and the business opportunity
- Close the appointment by getting a signed agreement (either as a customer or as an independent marketing executive/customer.)
- Follow up with the customer and/or independent marketing executive to ensure they understand how to obtain the benefits of the system

If the system is a referral model, then more emphasis is required on marketing (creating awareness) and less on selling. If the system requires direct selling of products to customers on an ongoing basis who do not become members, then more emphasis is required on

selling (persuading customers to buy products.)

### ***What kind of network marketing business to pursue***

Since the emphasis of this article is to convince an entrepreneur to have a network marketing business, there is a built in assumption that they have some other activities which may be more important to them. These activities could include other businesses, ongoing research, or a job.

Therefore, the network marketing business should be a secondary activity, unless the entrepreneur wants to pursue it as a primary activity.

However, if the business becomes successful, then it could become a primary activity of the entrepreneur.

Therefore it is important first to be in the right mindset in terms of expectations and commitments, but then to follow through with action.

Consequently, the simpler the business model is, the less likely it is to be a distraction. The more the products are in demand by consumers, the more the likelihood of being able to build a business successfully.

The simplest business system is the referral model that focuses on products the customers are willing to buy from someone they know – referrals from existing customers will generate sales if those customers can demonstrate successful results themselves.

The best kinds of products for referrals are personal and household care lines, because people will buy them when they know that they have worked for others.

Such product lines include, but are not limited to:

- Heart health, weight management, and nutrition
- Pain relievers and first aid
- Bath and body
- Skin care and cosmetics
- Household cleaners

In order to generate a sufficient volume of business per customer per order period, it will be necessary to have broad product lines from which customers can chose specific products every month based upon regular consumption. These choices may not necessarily be the same each period, but the customers should have a regular need.

Therefore, the best kind of business is based upon attracting a certain level of spending which prospects are already incurring on products that they need.

If the independent marketing executive can persuade a prospect to switch a certain amount of their spending on products that they already use, that may be higher quality or lower

price, or both, and refer others to do the same thing, without incurring a lot of expense, then the business opportunity may be the best for them.

### ***How to get started***

1. Build an aspiration (dream) as a reason for building a network marketing business that is strong enough to overcome fear of starting (rejection and doubt.)
2. Identify the best opportunity and find a trustworthy independent marketing executive already in the system:
  - a. Personal and household care products for which there is an ongoing need.
  - b. Small share of monthly spending to generate a referral commission.
  - c. Higher quality or lower price, or both, than regular brands.
3. Become a customer and immediately switch to as many products as possible to become familiar with them.
4. Build an approach to managing the business – the manufacturer or other independent marketing executives may be able to help here – such an approach might include:
  - a. Marketing materials
  - b. Contract lists and tracking forms
  - c. Prospecting approach scripts
  - d. Presentation materials
5. Start referring friends and family to build a small stream of residual income
6. Built a contact list of prospects
7. Approach prospects to schedule appointments
  - a. Hot market – family and friends.
  - b. Warm market – acquaintances.
  - c. Cold market – cold calls.
8. Make presentations and closes
9. Follow-up with new customers
10. Perform training to duplicate the process

If done properly with the right system, network marketing can be a great training aid for business development skills in general, and very lucrative in terms of income.

A few points to bear in mind:

1. Network marketing, as with any marketing and sales endeavor is a ratios game – meaning that of every so many calls and approaches made, a certain number will close with a new customer or independent marketing executive – overtime the closing ratio will improve. Therefore, to monitor performance, it is useful to track the number of calls to appointments scheduled, and the number of appointments to successful closes. Set goals such as 1 in 3 for appointments, and 1 in 3 for closes, meaning that calls to closes would be 1 in 9. Using these ratios as an expectation, the assumption is that more people will say no than say yes. Eventually, most people should say yes.
2. People buy on emotion and justify their purchases with logic – therefore the selling experience should be all about buying. There are three reasons why people buy:
  - Association (with a brand)
  - Incentives
  - Fear of loss