

COLUMN

Inside Network Marketing

Binary BS — Part 1

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There are four basic types of MLM compensation plans.

There's the Stair Step Break-Away, like Nu Skin and Herbalife use. You can build as wide as you wish on your first level and you are usually paid a percentage of all or part of a leg, or branch, of your downline. Actually, I like the break-away plan, although it is considered somewhat old-school today.

Break-Away plans have a hard time competing with more contemporary pay plan designs that have relatively easier qualifications and simpler structures. For example, the oddly named Unilevel plan (it has nothing to do with being "one" level).

With this type of plan you can also build as wide as you want, but you're paid a percentage of the sales volume that occurs on each level. Companies like Freelif, New Vision and Xango use this type of plan. I like the Unilevel, too, as do the majority of almost 7,000 distributors who were asked to rate each type of plan (MarketWave survey; 1991-present).

There's also the Matrix plan, which I also like. In this type of plan there's a limit as to how many people you can place on your first level. Although as old as the Break-Away and usually as simple as the Unilevel, the Matrix peaked in popularity in the late '80s. Today few prominent MLM companies remain that employ a matrix style plan. Melaleuca would be one of them.

And then there's the Binary plan.
I don't like Binary plans.

The Birth of the Binary

The Binary was invented by a man named David Crowe. In the Fall of 1989 he launched a company called "American Gold Eagle" (AGE) which marketed gold coins using the world's first Binary compensation plan.

Although some states had issued Cease & Desist orders against Crowe and his company, after two years of business AGE failed all by it's own bad self. But not after, according to insiders at the company, they were receiving literally *hundreds* of angry calls *per day*, and the Attorney General's office of their home state, North Carolina, was flooded with complaints.

Over five hundred remained unresolved alleging losses of over \$370,000. Next, Mr. Crowe, along with his wife Martha, took his new pay plan invention to Kentucky where he launched another gold coin scheme in January of 1992 called Gold Unlimited, which later at trial their own attorney would claim used a marketing plan "pretty much identical" to American Gold Eagle's. The Kentucky AG's office was a little quicker on the draw. In April of 1992 they issued an injunction against Gold Unlimited and enjoined the Crowe's from continuing its operation.

In October of 1993 the Crowe's signed a settlement agreement that allowed them to resume their business if they promised to make changes and play nice. They did neither. They relaunched what was technically a new company which, for the first time, referred to their compensation plan as a "binary" plan. This was likely due to the emerging popularity of the plan which had by this time already been adopted and referred to as a "binary" by upstarts Alliance USA, Jewelway and Market America. To completely avoid the stinky stigma associated with the name Gold Unlimited, they decided to call their new venture – *Gold Unlimited III*!

David Crowe was said to be very intelligent with a remarkably high IQ. He appears to be yet another example of the difference

between intelligence and common sense.

But I digress.

After receiving Cease & Desist orders from several states, in March of 1995 federal agents raided the Gold Unlimited home office – I mean, Gold Unlimited // home office – and they were slapped with a Temporary Restraining Order. Soon after the company closed its doors leaving 96,000 "Associates" with the brand new title of – victim.

In July of 1995 the government filed a 23 count indictment against both David and Martha Crowe, which included mail fraud, securities fraud, money laundering, and of course operating an illegal pyramid scheme. David and Martha were eventually convicted and sentenced to eleven and ten years respectively.

However, in another demonstration of intelligence vs. common sense, the Crowes were allowed to return home for a short time, unescorted, to get their affairs in order. The day they were to turn themselves over to begin their prison sentences, they didn't show up. They were on the lam for four-and-a-half years and were even featured on the television show "America's Most Wanted" (www.amw.com/fugitives/brief.cfm?id=24459).

In fact, that's what eventually led to their recapture in July of 2001. After the show aired, and in spite of a complete makeover, the pair was spotted by an American-Gold-Eagle-eyed resident of the Key West trailer park where they were living. They were found with quite a bit of cash, firearms, books on how to change your identity, a lot of jewelry and, of course, bags full of gold coins. Also in their possession was an expensive boat that they allegedly used to make numerous trips to the Cayman Islands (over \$10 million was unaccounted for when Gold Unlimited was liquidated). Even though the fugitive Crowes could have afforded to comfortably live anywhere in the world, they strangely opted to stay in the United States. There's that intelligence/common sense thing again.

Binary Blues

So that's how the binary baby was born. And its adolescence was a little rocky as well. Binary plans became the darling of pyramid scheme promoters and most of the scams at the time were using binary-type pay

structures. In the early to mid-90s there were a plethora of calling card companies (Destiny Telecom, STS, TeleSales Inc., etc.) and travel companies (Travelmax, World Class Network, etc.) and even other gold coin schemes that had a binary plan – and all faced lethal legal scrutiny.

But in every case it was the product value that was challenged, not the design of their compensation plan.* In fact, several of these companies had their business temporarily halted and were forced by state regulators to make significant changes to their program before being allowed to resume business. And in every case, after the smoke cleared, they were all still using binary compensation plans. So my dislike for binary plans has nothing to do with legal issues.

It is a legal pay plan that suffers a guilt by association.

I don't like binary plans because of the way it pays! But I'm jumping ahead of myself. Back to our history lesson.

Having bad parents like the Crowes doesn't always mean the bad is baked into the baby's DNA. In the early 90s some other MLM visionaries saw the potential in the young binary plan and decided to try running legitimate products of value through it. Although the products were still challenged in the case of Jewelway (Jewelry) and Alliance USA (ephedra energy tablets) which resulted in their ultimate demise, they experienced great success early on with the binary plan.

Companies like Market America went the route of more traditional, consumable products and remains a successful "binary" company to this day. Since then other multilevel marketers of health and personal care products, such as Usana, Mannatech, and Longevity Network, have adopted the binary plan with varying degrees of success.

* The greatest legal challenge to AGE, GU and GU II was not their binary form of pay plan. It was that they only sold gold coins – simply another form of currency (kind of like an MLM company selling Susan B. Anthony dollars for \$1.00) – or they sold only paper certificates that could be accumulated and eventually redeemed for gold coins, but bonuses were paid on the certificates, not the actual coins.

Binary Basics

This isn't a primer on how the Binary plan works; this article is about how it *doesn't* work. But you should have at least a fundamental understanding of its mechanics, otherwise you'll probably be lost from here on.

In a traditional binary plan you have three positions, or "Centers" positioned in a triangle (one with two below it). The bottom two positions then also have two legs branching off of them. All positions only have two legs. You can never go wider. At the end of a "pay cycle" (usually a week, sometimes a half-month or even a day) you are paid a percentage of the commissionable sales volume in the "weak leg" (the one with the lesser total sales volume), rounded down to the previous sales volume increment.

For example, you might earn 20% on the weak leg volume when it reaches at least \$1,000 during the week, then in increments of \$1,000 on up to a maximum of \$5,000 in volume. So if you ended the week with \$2,900 in one leg and \$3,500 in the other, you would be paid on the lesser side rounded down to the last \$1,000 increment, which in this example would be \$2,000, so you earn \$400 (20% of \$2,000, not \$2,900).

The extra \$900 in the weak leg is carried over to the next week. The \$2,000 you were paid on would also be removed from the strong side and the extra \$1,500 carried over. Any sales volume over \$5,000 in each leg during the week would be "flushed", which is pretty much self descriptive.

Typically you would have to achieve a certain amount of personal sales volume upfront to "activate" your centers, then you would be paid a higher percentage of the lesser leg's volume as you produced higher amounts of personal sales each month. Once a center is "maxed out", meaning it's producing the maximum payable volume in each leg (usually \$5,000), you earn a new center which you may place anywhere in your downline and begin building under.

The Broken Binary

Earlier I dropped the name Longevity Network as a company that used a binary plan. Just so there's full disclosure, I should say that I was one of their top distributors for nine years before leaving in January of 2004 to start my own MLM company – with a binary plan.

Let me explain.

It was September of 1995 and the owners of Longevity Network, Jim & Adi Song, had gathered 55 of their top leaders to participate in a two day think tank. They wanted to know what we liked and disliked. What we wanted more of, and less of. At the time Longevity had a compensation plan that was sort of a hybrid between a Unilevel and a Breakaway, but *looked* exactly like a breakaway, which had already become an unfashionable pay plan.

We explained that we were tired of having to deal with the breakaway backlash and that we needed a whole new plan. So the following month I found myself in a room with Mr. Song and several other members of the "Compensation Plan Committee". Jim drew "Pro" and "Con" columns on a white board below the names of each type of pay plan. When we got to the Binary plan we added "Builds deep, not wide" and "pays weekly" in the Pro column. Then we started filling up the Con column. We ran out of room.

Here are the top three "Cons" to conventional Binary plans:

- 1) New distributors need to see some kind of return for their efforts quickly.

It's very motivating to get a check in the mailbox, even if it's a small one.

Paying weekly or semi-monthly like most Binary plans do would then be a benefit as opposed to the more traditional monthly pay out employed by all other types of plans.

However, virtually all binaries up until the late 90s equipped their plans with some type of delay mechanism. One popular binary

program didn't cut you your first check until you achieved at least \$1,200 in sales in the weaker of your two legs.

You could work for weeks, or months, and have \$1,150 in sales in one leg, and \$5,000 in the other, and they *still* wouldn't cut you a check! Many others required at least a one-third/two-thirds balance between the two legs. So if you had a huge sales organization, but one-fourth of the volume was in one leg, again, no check.

- 2) Most binaries back then didn't pay you on all the sales even in your weak leg. They paid on certain sales volume benchmarks you had to hit, and if the volume fell in between these increments it would be rounded down to the last increment you hit and you'd be paid on that amount rather than the total volume in the leg.

The extra volume would be carried over to the following week. Paying on these sales increments rather than simply paying a percentage of the total volume serves only one purpose – to create breakage!

That is, to have sales volume always sitting on the table where you can see it, but in the vast majority of cases to never have to actually pay on it!

Think about it. Why else would such a system be used? It's certainly doesn't make it simpler to understand (note that "simplicity" didn't go into the Binary "Pro" column). It doesn't benefit the distributor at all. Indeed, this aspect of a binary plan serves one purpose – to create sales volume the company doesn't have to pay on, and hide that fact very well.

Here's how they do it: Let's say you have \$1,900 in your weak leg, and the plan pays on each \$1,000 increment up to \$10,000. So since you didn't quite make it up to the \$2,000 increment you're paid on \$1,000, the last one you did hit, and \$900 is carried over to the following pay cycle. When challenged, they'll tell you "That's not so bad. You'll just get paid on it next week."

Really? So what if the following week your lesser leg does another \$1,900 in volume? Add in the \$900 that was carried over from the previous week and you'd have \$2,800. And you'd be paid on \$2,000 and \$800 would be carried over. Who's to say that's not from the same \$900 that was carried over from the first week?

They can play all the number games with this they want, but the bottom line is that you had \$900 in unpaid sales after the first week, and now you still have \$800 in unpaid sales – all of which would have been paid on in non-binary plans. So let's jump a few weeks ahead to where you now begin the week with, let's say, \$500 of carried over sales in your weak leg, and that week the leg generates \$9,900 in sales. You now have \$10,400 in total sales, the plan only pays up to \$10,000, so \$400 is "flushed". Not carried over. Gone.

Visualize this analogy: You have a pile of cash on the table, and you take a squeegee each week and move a chunk of the pile towards the edge of the table. The pile you push forward increases and decreases pretty much at random. Eventually, inevitably, you push a portion of that pile off the edge of the table. Your MLM company's CFO then comes in the room, gathers up all of that cash from the floor, thanks you, and leaves.

Yes, it's true that, on rare occasions, the amount of volume in the lesser leg might hit on or close to the pay increment leaving little to carry over. But that's based on random chance, and the odds are against it. In fact, if the increments were evenly spaced \$1,000 apart like the above example, the company would be carrying over, on average, \$500 in sales every week per distributor. Now imagine a company with 100,000 active distributors, every one of which having some amount of volume trapped in between those increments (some weeks \$1 is carried over, but just as many weeks \$999 would be carried over, or any amount in between). That's literally millions of dollars of non-commissioned sales volume that will *always* be there, week in and week out, for as long as the company exists.

3)Of course, the greatest flaw in the binary design is the "lopsided legs" syndrome.

What if you personally enrolled only one person, but they became the #1 commission earner with a million dollar monthly downline? As the person who brought this superstar to the company you'd think they would richly reward you for this, right? But no, not in a conventional binary.

In fact, in this worst-case-but-not-so-far-fetched scenario, you would not even receive a check! You would only earn a percentage of your weak leg, which would be empty. Here's where the binary apologist will explain, "It's that great?! They built half your organization for you! Now just go out and build the other half!"

Here's another analogy to visualize: You're a dusty ol' 49er out prospecting for gold in the Sierra foothills of California. You find a nugget. A *really* big one. You hop on your horse and high tail it down to the nearest Wells Fargo. You stumble in carrying your bowling ball sized bullion and drop it on the pinewood counter with a thud. The banker groans as he strains to hoists it up onto the scale. The glistening bolder again crashes back to the counter, slightly buckling the scale's brass tray. The banker leans closer to the scale, then looks up over his bifocals directly at you and says, "Ain't worth nuthin' yet. Git back out there and find enough gold to balance this here scale, and then I'll pay ya' fer it."

No, that's not great.

Here's where those same binary apologists will suggest you simply focus all your efforts on the weaker leg and yes, try to balance it out. But alas, the strong leg is called that for a reason – there's a lot more people in it! You and a few others might be trying to catch up to the recruiting efforts of several times as many people. The reality of the math just doesn't jive with the advice.

New Breed of Binary

So back to that fateful Fall day in 1995, when the binary got fixed. The "Con" column of our binary comparison was quickly becoming the "strong side". But the first item in the "Pro" side was a *really* strong pro. Based on an abundance of research I had already done by then I knew that

historically plans that built in depth (where you place people one below the other) generally created less attrition and got people into profit faster.

Distributors also stated a strong preference to build in depth as opposed to width (placing everyone on your first level).

Building in width created competitors. Building deep created partners.

It was years later that I'd add the question to my MarketWave survey's "Do you prefer to build in depth or width?" After almost 400 responses so far depth is beating out width by *four-to-one*! So a question was asked that literally changed the face of MLM compensation plans forever:

"How do we maintain this one great Binary Pro, but fix all the Binary Cons?"

And that's exactly what we did that day. Piece by piece, we deconstructed the binary plan and rebuilt it from the ground up. And the result was magnificent!

Some fixes were simple, and almost too easy. We didn't like the balancing or minimum weak leg volume requirements, so we just removed them. If someone had one dollar of sales in the left leg and a thousand in sales in the right, pay them on the buck. We didn't like the sales volume increments in the weak leg (where volume was rounded down to the last increment and the excess carried over), so we just stopped doing it. If someone had \$1,544.36 in weak leg volume, we'd pay them on the entire \$1,544.36 and not carry over anything.

We also found that a lot of distributors had a problem with managing three sales centers and trying to balance four legs. Besides that some companies were already getting busted for selling multiple centers, and seven (three levels, 1+2+4) seemed to be the legal line being drawn in the sand by regulators. Besides the fact we could find no benefit to having

three centers over building just one (you can always make that one center pay three times as much), we weren't that comfortable being just one step over that line.

We wanted a little more of a buffer separating our plan from the one's used by FTC dart board darlings Skybiz and Jewelway. Not only that, but I did a focus group with 40 subjects and asked them,

"If the total pay out was the same, would you prefer to build four legs beneath three centers, or two legs beneath one center?"

It was the first focus group I'd ever conducted where the results were completely unanimous. Besides the two subjects that claimed to loathe all binaries and refused to play along, literally 100% of the others said, absolutely, building just two legs under only one position was better. So, we raised the percentages and lowered the flush point to make the single center pay as much as three centers would, and lost the extra two centers. Now, by concentrating their downline into two legs instead of four they'd get even *more* depth, even *faster*. So yes, some parts of the binary that did things we didn't like were fixed by just not doing them anymore.

But there was still one more con to conquer. How do we pay ol' Wyatt for his solid gold bowling ball – right now?

Introducing... the *Matching Bonus*!

About as many companies today claim to have invented the concept of a matching bonus in a binary plan as there are companies using a binary plan. Actually, there are two names that can make this same claim to fame. One is the aforementioned Jim Song, who introduced the binary match to the U.S. market back in 1995 (find one before then – I dare you). The other is Anthony Diaz who, right about the same time, was designing binary matching plans in Japan. Anyone else making this claim is either fibbing, or sincere but mistaken.

By paying a distributor the same commission that is earned by those they sponsor offers multiple levels of benefits, no pun intended (okay, maybe a little one). First, it dramatically increases the level of support one gets from their sponsor. When he or she is going to get paid the same commission you get paid, they tend to try a little harder to get you paid. It also offers a true "infinity bonus".

Unlike the "infinity" bonuses used by many unilevels, which pay down to the next person who also qualifies for this bonus and then stops (Mr. Webster and I have a very different definition of infinity than most unilevel plan designers – we believe infinity means *doesn't stop*) the matching bonuses allows you to *actually* get paid on volume as deep as it goes. If you sponsor someone and place them 500 levels deep and they build a sales organization that earns them a \$1,000 commission, as their sponsor you would earn a \$1,000 matching bonus. This would be income derived specifically and entirely from sales volume over 500 levels deep in your downline (whether the company searches one level up to find the sponsor to pay this bonus to, or 500 levels upline, it's the same \$1,000 expense to the company – so no, this won't bankrupt them).

The matching bonus also allows you to get paid on "flushed" volume since the volume that goes over the maximum amount commissions are paid on are virtually guaranteed to be under at least one person you sponsored, whose commission you are matching.

And, best of all, it allows you to be paid on volume in your *strong leg*! So now, if you sponsored only one person and they became the #1 commission earner in the company, and you had one million dollar leg and one empty leg, not only would you still get paid you'd very likely be the #1 *matching bonus* earner in the company. You'd be earning a sizable income from essentially a *one legged* downline.

Messing Up a Good Thing

But, alas, some companies just couldn't leave well enough alone. Soon, the matching binary became arguably the most copied compensation plan concept in MLM history. Inevitably all the benefits and advantages offered by this genuinely revolutionary pay plan model wasn't good enough for some to stand on its own merits. They *still* felt the need to embellish it with BS and cloak it in smoke and mirrors. Also, all that commission breakage that was so near and dear to the hearts of MLM owners – and in some cases their shareholders – was sorely missed. In an effort to

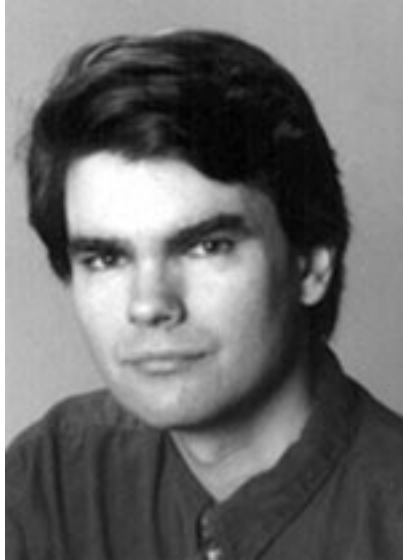
reintroduce it into the plan but remain competitive they began to come up with masterful, and in some cases dangerous ways to accomplish this.

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Lest this article consume this entire publication, it's also going to have to pay out down a finite number of levels— which is right here. So tune in next month for a detailed, case-by-case exposé of all the most sinister schemes, or at best sincere snafus, being foisted on binary plan enthusiasts across the country.

Fair warning: If you're involved with an MLM company whose binary plan was designed since the turn of the century (2000), chances are you're going to at least catch some shrapnel from Part II of this article. Some will be obliterated by direct hits. Either way, it won't be pretty.





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