

# Why do people join pyramid schemes?

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## **Abstract**

### *Purpose*

Pyramid schemes create an unusual situation, where the victims might be effectively turned into offenders, as their role is to recruit more victims to the pyramid scheme. This paper investigates the prevalence of pyramid schemes, their modern forms, and why people join them.

### *Design/methodology/approach*

This paper has developed from a structured literature review carried out as part of a wider study into policing pyramid schemes.

### *Findings*

The paper identifies a range of reasons why people join pyramid schemes. Some of these reasons are “participant dominant”, including the vision of high reward for little work and the attraction to a better lifestyle. Other reasons are “organiser dominant”, including the exploitation of specific groups and high-pressure sales. These findings suggest significant differences in levels of culpability of pyramid schemes victims and perpetrators. This complexity is accompanied by conceptual, regulatory, and institutional challenges.

### *Originality*

Despite the profound and pervasive impact of pyramid schemes, researchers know very little about why some people participate in pyramid schemes. Limited research is largely American and specific to illegal multi-level marketing schemes. To the best of the authors’ knowledge, this paper is the first to provide an overview of a mix of strategies of participants of pyramid schemes to recruit new victims and reasons why people are joining pyramid schemes.

### *Keywords*

pyramid schemes; victims; offenders; economic crime; deception; dishonesty; policing

# Introduction

Some forms of economic crime such as chain letters and pyramid scams have become so notorious that one might wonder why people still fall for them. There are many factors that reinforce and enable traditional forms of economic crime, some of which are linked to societal and economic crises (Levi and Smith, 2022). Because of rapid changes in the economic climate – such as unemployment, loss of income, and inflationary pressures –, the evolution of technology, and growing societal strain, even well-known forms of deception and dishonesty might thrive (Hanoch and Wood, 2021).

The problem of pyramid schemes, including their various forms such as gift schemes and illegal forms of direct marketing, illustrates the success of traditional forms of deception and dishonesty. What is special about pyramid schemes is that they are enabled by an active participation of victims. While many participants in pyramid schemes lose cash and/or suffer other harms, the vast majority of participants also facilitate illegal pyramids by actively recruiting new victims in an attempt to turn even more people into active recruiters (Msosa, 2022). Some participants know what they are doing might be a pyramid scheme, but think they are in a position to recruit a large number of other victims to join the scheme (see Hidajat, 2018). This puts most participants in a position of a victim who is effectively trying to become a perpetrator, with the vast majority of them failing to do so.

Despite the profound and pervasive impact of pyramid schemes (see Button and Cross, 2017; Shen, 2020), researchers know very little about why some people participate in pyramid schemes. Limited research is largely American and specific to certain forms of pyramids, especially illegal multi-level marketing (MLM) schemes (Liu, 2018; Nolasco et al., 2013; Walsh, 2016). This paper aims to contribute to this small body of research by investigating why people join pyramid schemes. The remainder of this paper is structured as follows. The paper first introduces the concept of pyramid schemes and discusses their prevalence. The paper then analyses strategies of participants of pyramid schemes to recruit new victims and reasons why people are joining pyramid schemes. Finally, the paper provides a conclusion.

## Pyramid schemes and their prevalence

### *Concept of pyramid schemes*

Modern pyramid schemes can trace their origins to 1888 in the US. These schemes were associated with the so-called “chain letters”, where the recipient was encouraged to send dimes to the sender and forward the letter to others (Stollznov, 2014, pp. 61-75). These letters included a list of names and the first on the list was being paid by the recipient of the letter. The recipient then crossed the name on the top of the list and added their own name to the bottom. Paradoxically, the growth of chain letters was facilitated by the growth of literacy.

More recently, the expansion of the internet, social media, and associated technologies have enabled chain letters and new types of schemes to grow exponentially and reach global audiences (Button and Cross, 2017).

Pyramid schemes have evolved into a diverse and constantly changing range of schemes. Consider, for example, the \$300 million Forsage crypto pyramid scheme, which included millions of investors globally. The United States Securities and Exchange Commission (SEC) has charged eleven organisers and promoters of the scheme that used aggressive marketing techniques to convince participants to invest and recruit others into the scheme (Financial Times, 2022). According to the SEC's complaint, in January 2020, the organisers launched a website that allowed millions of participants to enter into "smart contracts" operated on Ethereum and other blockchains (SEC, 2022, pp. 1-2). These contracts operate as computer programmes that allow trading with cryptocurrencies to take place without a central intermediary.

However, the purpose of the smart contracts was not to sell any actual product to customers but to defraud investors. The key issue in the scheme was that:

To participate, an investor created a crypto-asset wallet and then purchased "slots" in Forsage's smart contracts, which gave the investor the right to earn compensation from others whom the investor recruited into the scheme (the "downlines") and compensation from the larger Forsage community of investors in the form of profit sharing of payments known as "spillovers." When an investor purchased a slot, a portion of that investment was directed to the persons who recruited the investor (the "uplines") and the investor in turn became an upline to whomever the investor recruited. Thus, all payouts to earlier investors were made using funds received from later investors (SEC, 2022, p. 3).

And the focus on profit linked to recruitment of new participants by earlier participants rather than selling any actual, consumable product or service to genuine customers is the key distinguishing feature of pyramid schemes (Garner and Black, 2004).

The Forsage scheme also illustrates the overlap between pyramid schemes and Ponzi schemes. The distinguishing feature of Ponzi schemes is not the compensation associated with the recruitment of new participants by earlier participants but a fraudulent investment opportunity that depends on "a steady cashflow from new investors to pay out existing investors who want to withdraw their initial investment or any profits." (SFO, n.d.). While some Ponzi investors can be completely passive, the Forsage scheme illustrates how the primary way for investors to make money was to recruit others, which is the key feature of pyramid schemes. At the same time, the scheme features an investment fraud that is sustainable only until later investors are able to compensate earlier investors, which is the key feature of Ponzi schemes. This overlap between pyramid schemes and Ponzi schemes causes confusion in both academia and policing practice (Tajti, 2019).

Moreover, unlike Ponzi schemes, many pyramid schemes are not criminal, or even fraudulent. Consider illegal forms of MLM associated with the direct selling of goods and

services (Pratt, 2000), which typically are regulated under consumer protection laws and might constitute an unfair business practice. For example, the Herbalife scheme, an alleged pyramid scheme resulting in a US\$200 million settlement with the US Federal Trade Commission in 2017, involved over 350,000 victims. These victims suffered loss by buying into becoming distributors of nutritional products with little or no due diligence and recruited further members based upon false premises (Time, 2020). Such schemes often operate in a legal hinterland and policing authorities must prove that they are unfair to consumers. In some countries such as the US, policing authorities have developed sophisticated tests examining the overall operation, and an economic justification of these schemes. Many countries, however, struggle to find a legal basis and resources to undertake a fact intensive, case-by-case analysis which is needed in these cases (see Federal Trade Commission, 2011).

### *Prevalence of pyramid schemes*

Pyramid schemes by their very nature aim to involve large numbers of persons. The Albanian “pyramid” investment scheme at its height involved over a million, covering two thirds of the population (Jarvis, 2000). Some of the cases involving companies operating at the edges of legitimate MLM and illegal pyramid schemes, such as the above-mentioned Herbalife case in the USA, have involved tens of thousands of “victims”. For example, in a pyramid scheme from South Wales and the West Country in the UK, 9 organisers were convicted for a scheme that involved over 10,000 victims who signed up to the scam with £3000 on the promise of £23,000, if their “small pyramid” reached its potential (Competition and Markets Authority, 2014).

For a variety of reasons these large numbers do not transfer into established recorded measures. Many do not realise they are victims, lots who don’t report and those that do often find it difficult to report (Button et al., 2009). Additionally, as with most types of mass marketing frauds there are challenges in estimating the size of the problem due to definition challenges, the grey area of legality/illegality and a variety of other issues (Button and Cross, 2017). These equally apply to pyramid schemes including, for example, the unclear division between lawful MLM and pyramid schemes as well as the fact that not all illegal pyramid schemes are necessarily frauds.

The most common ways to measure the extent of illegal mass marketing, like pyramid schemes are either prevalence surveys or recorded/reported case statistics. The former are more accurate and are based upon samples of the population surveyed to ascertain if they have been victims. Such techniques enable estimates of victimisation in the general population. Recorded/reported statistics are less useful as they represent only those who choose to report. Many don’t and ultimately the numbers can be significantly influenced by regulatory bodies’ activity to encourage and accept reports. At best they represent a barometer. Some of the evidence of the extent of pyramid schemes around the world will now be considered.

The US Federal Trade Commission has conducted four prevalence surveys that have included specific data on pyramid schemes in 2004, 2007, 2011 and 2017 (Federal Trade Commission, 2004, 2007, 2013, 2019a). These surveys illustrated very large numbers of the population who were victims of consumer fraud in general and within that a large number of incidents of pyramid scams. Between 2004 and 2017 the percentage of American adults who were victims of consumer fraud was 16.3% in 2004, falling to 13.5% in 2007 and then 10.8% in 2011, before rising to 15.9% in 2017. By comparison during this period victims of pyramid schemes started at 0.7%, then falling to 0.4%, 0.3% and 0.2% respectively. This was not the most common fraud (fraudulent slimming products were), but still in 2017 there were 0.4 million victims and incidents. The UK (England and Wales) has excellent data on fraud victimisation from the crime survey for England and Wales (CSEW). Unfortunately, this does not break down data to the level of pyramid schemes. There was, however, a one-off prevalence survey of mass marketing fraud conducted for the (now defunct) government agency the Office for Fair Trading (OFT) in 2006. This found 6.5% of the adult population (3.2 million) had been a victim of a mass marketing fraud/scam in the year of the research and 480,000 or 0.98% had been the victims of a pyramid/chain letter scams (OFT, 2006).

Less reliable reported data has also demonstrated the size of the problem. The US Federal Trade Commission collects extensive data on consumer frauds/problems which are reported via the Consumer Sentinel Network. This data is published annually and represents reports by consumers about problems in a variety of consumer areas. They are not therefore confirmed cases of fraud or unlawful acts. Figure 1 below presents the number of reports for pyramid schemes and MLM between 2007 and 2021. It shows a steady decline from 2000 to 2019 from around 3000 reports to 2000 and then in 2020 and 2021 a substantial rise to around 8000 reports in the most recent, 1 four-fold increase in two years, albeit from a small base. Nevertheless, to put in context in 2021 they represented 0.14% of all reports (Federal Trade Commission, 2022).

## **INSERT Figure 1**

**Figure 1.** Consumer sentinel reports of pyramid/multi-level marketing problems (Federal Trade Commission, 2010, 2012, 2014, 2019b, 2022).

## **Why people join pyramid schemes**

Pyramid schemes are associated with a mix of strategies of participants of pyramid schemes to recruit new victims and explanations why people are joining pyramid schemes. This section will first discuss how some of the reasons to join pyramid schemes are “participant dominant”, including the vision of high reward for little work and the attraction to a better lifestyle. Further, the section will focus on “organiser dominant” reasons to join pyramid schemes, including the exploitation of specific groups and high-pressure sales.

## *Participant-dominant reasons to join pyramid schemes*

### *Economic factors and high reward for little work*

Perhaps the most significant reason many people join pyramid schemes is that they are joining a unique investment opportunity to engage in a business which enables them to make some good returns for modest effort with a degree of flexibility. Some authors provide empirical evidence that pyramid schemes are more popular in countries which have experienced greater economic contractions (Bosley and Knorr, 2018). For example, Time (2020) drawing upon a report for the Direct Sellers Association noted that the numbers of sellers for MLM firms, including some pyramid promotional schemes, in the US rose from 15.1 million during the 2007-09 recession to 18.2 million in 2014. With many finding themselves unemployed, struggling with loss of income and an uncertain future, a promise of high reward opportunity is appealing to many people.

The appeal of such schemes has been high around the globe. Consider post-communist countries, such as Albania, Romania and Russia, which in a process of rapid changes of economic and political structures have experienced major negative societal consequences associated with the rise of pyramid schemes (Musaraj, 2011). The Albanian pyramid scheme, for example, had devastating effects on the entire nation. With approximately half of the country's GDP being invested in pyramid schemes, their collapse resulted in rioting, the government fell, and a near civil war (Jarvis, 2000; Musaraj, 2011). Moreover, scholars analysing pyramid schemes in other countries such as South Africa show how pyramid schemes might serve as an attempt to resolve societal strain, when the society has unrealistic expectations of material success without offering sufficient means to achieve it (Krige, 2012)

When one focuses on individual cases, the economic factors explaining why people join pyramid schemes become even clearer. Deviant promoters of pyramid schemes might offer the promise of life changing amounts of money or they simply offer a flexible way to make good returns above normal rates of pay. Examining the problem of pyramid schemes in rural Siberia in Russia, Schiffauer (2018a, p. 291) notes how one individual tried to recruit the author to a MLM-based pyramid scheme by illustrating material success:

Lobsan switched on the screen to show me a short video of an American distributor who had become rich thanks to Amway. The man in the video took the spectator on a tour around his luxurious home, to his swimming pool surrounded by palms and to his car park while praising the company for the opportunities it had given to him. Switching off the video, Lobsan turned to me again and said that this must certainly have convinced me that Amway was a business that offered great prospects. As a start, I should sign up, buy a basic set of commodities for sale and, most importantly, begin to actively consume and familiarize myself with the Amway products.

The problem of high reward for little work is also common in the Western world as can be seen in a number of recent cases. Consider, for example the IM Academy, a scheme promising a recipe to get rich by investing into foreign exchange and cryptocurrencies (see El Pais, 2022), and the UK's Give and Take pyramid scheme defrauding at least 10,000 victims who were promised a £24,000 pay-out during "champagne celebration nights" (Guardian, 2014).

### Prestige and attraction to lifestyle

Some victims are attracted to the lifestyle joining pyramid schemes enables. The promoters of pyramid schemes exploit the presentation of an achievable and desirable lifestyle to involve victims (Schiffauer, 2018a and b). This has two dimensions: first it is the economic dimension and the research shows that this has been dominant, for example, in former communist countries and South Africa, where the achievement of nice holidays, good cars etc. are presented as plausible outcomes of involvement (Krige, 2012). Second, there is a particular lifestyle dimension to involvement where joining opens up social opportunities to join with like-minded people, whether that is an interest in entrepreneurship, physical fitness, healthy foods or investments to name some (see Time, 2020). Some schemes, for example, offer opportunities for social gatherings of like-minded individuals at banquets, events or even online meetings to name some. In some cases, events are used to build up loyalty of new members, including schemes related to improving physical fitness and schemes focusing on young mothers who might lack social networks.

Pyramid schemes are increasingly enabled by social media. A scheme has the potential to grow exponentially when large groups of like-minded people are encouraged to promote the scheme with other like-minded people. This is often founded in promotion of persons who have done exceptionally well from the scheme with messaging that others could also achieve these outcomes. The scheme can reach even higher levels of interest if celebrities or social media influencers endorse such schemes (Time, 2020; Harris, 2018). Members involved in selling through pyramid schemes are often encouraged to post signs of their success, especially when they are on holiday or in a good restaurant to highlight the successful lifestyle associated with the participation on a pyramid scheme.

### *Organiser-dominant reasons to join pyramid schemes*

#### Exploitation of affinity networks and other specific groups

Organisers and deviant promoters of pyramid schemes use a mix of strategies to exploit the vulnerabilities of victims. The exploitation of affinity networks and other specific groups have been the key issue in a number of high-profile schemes (see Amoah, 2018). Affinity groups, especially immigrant communities and religious groups have been particularly vulnerable because of their regular socialisation and strong social bonds. Bosley and Knorr (2018), for example, found higher levels of victimisation in US regions with large Hispanic communities and religious communities.

Furthermore, perpetrators are setting up pyramid schemes in a way to exploit the relationship between members of the same family. We see a number of instances when kinship networks were subject to targeted exploitation to maximise recruitment. Consider an example from rural Siberia:

Kinship bonds allow for setting up a meeting in intimate ways and also make it difficult to refuse “cooperation” as it is often put by recruiting distributors. Initially, Alima did not want to work for the company. On the contrary, she was unresponsive to or even dismissive of invitations. Only when her relatives made the invitation, she agreed to listen to more detailed information about the company. We do not know whether her

decision to join, which in retrospect she justified in economic terms, was a result of social pressure or whether her cousins' explanations convinced her that Amway would be a prospective business. Trust in her relatives' recommendations is likely to have played an important role for her decision. Unlike an anonymous representative of a multinational company, a relative is unlikely to be suspected of providing false information or of insincere intentions. In contrast, a close relative will be assumed to act in ways that are in line with one's interest (Schiffauer, 2018b, p. 296).

Furthermore, there is evidence that the very nature of some pyramid schemes is to target specific groups, young mothers, college students, and other specific groups who are likely to be interested in the particular product and service. For example, pyramid schemes rooted in cosmetics have targeted young women active on social media, college students have been targeted with crypto schemes, and women for spiritual and self-help groups (see Horton, 2021). This characteristic of pyramid schemes makes the question whether there is a typical profile of pyramid scheme victims relatively less important because a victim profile would often merely reflect who the scheme was targeted at.

#### High pressure sales

Once specific groups who are likely to be interested in the particular product or service are identified, pyramid schemes often involve high pressure sales to turn potential participants into victims. Snook (2005) details stages of the process associated with high pressure tactics, including:

- Family members, friends, or trusted persons are used to contact associates about an exciting business opportunity;
- They are invited to an event/meeting which is only scheduled once in the locality;
- They attend the event with the associate and are subjected to highly persuasive and pressured selling presentation;
- They are then offered a unique sometimes "time pressured" opportunity to join.

Once at a meeting or event, the attendees are subjected to an intensive sales programme that might last several hours. Schiffauer (2018b, p. 293) illustrates the opening of one such event:

The meetings are usually started with a number of questions to the newcomers: Whether they are happy with their standard of living (the answer is mostly negative), whether they have debts (always positive answers) and whether they could use more money (the reaction often being laughter: of course, who does not need more money?). In this case, so the conclusion drawn from the answers MLM would certainly be the best option for those present.

Furthermore, high-pressure sales have also been associated with tactics used by extreme religious groups and cults (Bosley et al., 2019). It is documented, for example, that some pyramid scheme victims were subjected to long training periods in isolated locations to secure their commitment to the scheme. Some have compared such intensive recruitment to "brainwashing" (Economist, 2018).



## Operating in legal hinterland

An important reason why many people ultimately join pyramid schemes is because perpetrators, especially perpetrators of illegal MLM schemes, are operating in a legal hinterland. Typically, in the USA large numbers of legal cases are contested over whether schemes are legal MLM schemes or illegal pyramids. Organisers by operating in a grey area make it difficult not only for enforcement authorities to tackle them but also for people to realise that they are joining an illegal scheme (Shen, 2020). Moreover, it is evidenced how pyramid scheme organisers use legal means to frustrate and warn off victims. Button et al. (2009, p. 65), for example, illustrate how one victim who had tried to expose the scam and sought their money back from the organisers was threatened with legal action, as they note:

[...] what they did to us is they took us to the solicitor because they said we were harassing them and I had a letter from the solicitor that I was, accused of harassment and if you do this again to this person, you know, consequences, they said.

These tactics are largely enabled by the uncertain legal status of MLM schemes, and clearly would not be pursued by unambiguous criminals. This is also the reason why it might be hard to secure law enforcement interest (see Button et al., 2009, p. 33). Indeed, the vast majority of pyramid schemes are not promoted as illegal schemes, and many people would walk away if they knew.

## Conclusion

Pyramid schemes create an unusual situation, where the victims might be effectively turned into offenders, as their role is to recruit more victims to the scheme. This situation is associated with a range of reasons why people join these schemes. Be it prestige, prospects of securing a lucrative job, or individual greed, some reasons are “participant-dominant”. Other reasons, including the exploitation of specific groups, high pressure sales, and exploiting regulatory gaps are “organiser-dominant”. These findings about the nature of pyramid schemes and reasons for joining them have important sets of implications for understanding the culpability of pyramid scheme participants and organisers.

The findings of this paper suggest significant differences in levels of culpability of pyramid schemes victims and perpetrators. Further research is needed to investigate various types of pyramid scheme actors and their culpability to inform the analysis of guilt and the adequacy of victim protection. For many participants, for example, the knowledge of an illegality of a pyramid scheme might not be a problem, if they perceive they are getting involved early at the top when there are chances of success. In other words, a suspicion that a scheme is a pyramid may not always discourage, as the perception of getting in early at the top of a pyramid can often override those concerns. Arguably, those participants who know about an illegality of a pyramid scheme, who fail to undertake proper due diligence, or those who are profitable clearly deserve less protection than those being seriously deceived, subject to significant pressure to join schemes, losing substantial resources, or being vulnerable victims.

Furthermore, the complexity of factors that play the role in pyramid schemes implies a large heterogeneity of approaches, including those based on consumer law, counter-fraud law, competition law, and anti-money laundering law, which deserve further attention and were not explored in this paper. For example, many of the “organiser-dominant” tactics will clearly fall under criminal counter-fraud laws of many countries. Others tactics might fall under consumer protection laws, especially when unfair forms of MLM are concerned. This leads to questions of who, how, and by whom should be sanctioned and protected with multiple competing approaches and authorities being relevant. These complexities deserve further attention so that cooperation and coordination challenges do not undermine the effectiveness of policing pyramid schemes.

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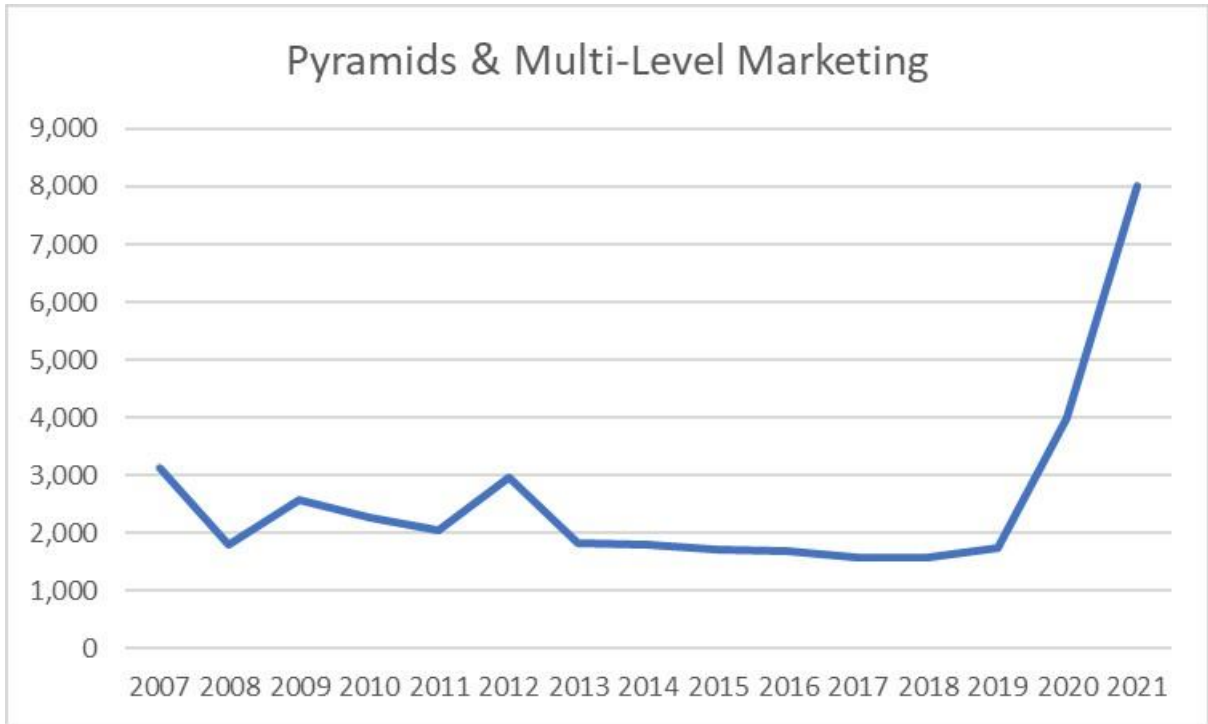


Figure 1.