

How to Analyze Compensation Plans

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One of the most important aspects to consider in a company is its compensation plan — the set of rules that dictates how distributors earn commissions, overrides, bonuses, and other compensation.

A Little History

After decades of classic door to door direct selling by the Fuller Brush Man, multilevel sales plans rose to popularity in the 1950s and 1960s (Amway, Mary Kay, and Shaklee), which allowed distributors to earn money not only on their own direct sales, but also to earn override commissions on the sales of the salespeople they recruited, the sales of the salespeople recruited by their recruits, and so on down the line. In the early programs — before the advance of computer technology — it was difficult for a company to manage all the downline information and payouts. So they usually allowed only "direct distributors" to buy directly from the company. These people would then sell products to the distributors in their downlines, collecting payment from them, and paying them their commissions, bonuses, and overrides.

Today, thanks to affordable, powerful computers, as well as efficient delivery systems such as UPS and Federal Express, there is no longer a need for direct distributors to act as go-betweens. The new companies and most of the older ones now allow all distributors to purchase directly from the company.

Go for the Goals

When choosing a company to join, the most important factor is not the type of compensation plan, but whether that plan is achieving important goals for distributors. Alfred White, senior management consultant at San Diego-based Hamilton LaRonde & Associates, Inc. recommends evaluating each company you are considering against the following characteristics of a good compensation plan:

1. Is it easy to enter into the opportunity? You should only have to buy a modestly priced sales kit.
2. Are you rewarded primarily for direct sales, rather than for override commissions?
3. Are you rewarded for personally sponsoring others?
4. Are you rewarded for recruiting multiple levels?
5. Is the focus on selling products to the end consumer, rather than to your downline?
6. Are you rewarded for training and supporting your downline?
7. Are you rewarded for high personal volume?
8. Are you rewarded for high group volume?
9. Are you rewarded for maintaining a monthly volume?
10. Does the plan provide for recognition?
11. Does the plan offer nonmonetary rewards and incentives, such as trips or cars?
12. Is the plan's monthly maintenance requirement reasonable - not so high that you can never achieve it, and thus never receive compensation?

Conversely, here are some compensation plan characteristics that should send you running in the opposite direction:

Four Major Types of Plans:

[The Unilevel Plan](#)

[The Stairstep Breakaway Plan](#)

[The Matrix Plan](#)

[Binary Plan](#)

1. A plan that does nothing to discourage deadweight distributors and nonproducers.
2. A plan that encourages inventory loading or large investments in products.
3. A plan that emphasizes gimmicks rather than product sales.

Four Major Types of Plans

There are many different varieties of compensation plans out there. They often have exotic names. But they tend to be variations on four major types of plans....

The Unilevel Plan

In this plan, recruits do not advance to positions above basic distributors, regardless of their performance. According to White, the principal advantage of the unilevel plan is that it's easy for companies to administer and for distributors to explain to potential recruits.

Its chief disadvantage is its lack of flexibility in achieving some of the goals mentioned earlier. In addition, unilevel plans are limited in depth of levels of payment which inhibits deep sales organizations. Instead, front line width occurs which may cause sponsors to be "thin" in support. Over time, most companies that start with unilevel plans adapt them to look more like a stairstep breakaway plan.

The Stairstep Breakaway Plan

This is the oldest and most common type of network marketing compensation plan. After meeting certain performance criteria, a distributor advances in rank and "breaks away" from his or her original sponsorship line. The original sponsor receives a percentage override on the sales of the entire breakaway organization. In a way, a stairstep breakaway plan is a unilevel plan with the flexibility to motivate distributors to perform and advance.

Its chief advantage, says White, is that it has a good track record, is easy to modify, is accepted by regulatory agencies, and is driven by volume and performance.

The primary disadvantage of this plan is that it is sometimes so complicated that it's difficult to explain to new recruits. Another disadvantage is that if the company does not monitor its distributors, they tend to get involved in inventory loading. And sometimes, there is an unreasonably high ongoing monthly personal purchase volume requirement.

Nevertheless, the stairstep breakaway plan remains the most tried-and-true type of plan out there today — and the most likely to survive in the decades to come.

The Matrix Plan

This plan looks like a grid in which a distributor is limited to a certain number of recruits at each level. For example, in a 3-by-5 matrix, each level down to five can have only three downline distributors.

This type of plan is sometimes considered to be more gimmicky than others. Why? Because due to the width limitations, new recruits may find themselves placed underneath upline distributors who did not directly recruit them. In a three-wide matrix, for instance, the fourth distributor you personally sponsor would be placed under one of the first three distributors you personally sponsored (your first-level distributors).

This automatic filling of spots in the matrix can be attractive to novice distributors if they sign on with strong leaders who help fill their grids. Also, it works well in companies where most of the products are used by the distributors, rather than sold to outside consumers.

Matrix plans have been subjected to attacks by regulatory agencies because they sometimes look like "a game." By and large, they have not had a successful record in the industry, and they foster nonproducers, which makes the upline

distributors resentful. Nevertheless, several major companies operate matrix plans. Only time will tell whether these plans are here to stay.

Binary Plan

The binary plan is the newest on the scene. In a binary plan, a distributor is allowed to occupy one or more "business centers," each limited to two downline legs. Compensation is paid on group volume of the downline legs rather than a percentage of sales of multiple levels of distributors. In other words, payment is volume driven rather than level driven. Sales volume must be balanced in the two legs to be eligible for commissions, which are paid at designated points when target levels of group sales are achieved. The distributor may occupy multiple positions and may re-enter or loop below other two leg matrices in which he or she has been active. There is no depth limit on payment but each matrix has a finite amount that can be paid out, thus necessitating involvement in multiple two leg matrices. Payment in binaries is often on a weekly basis.

Proponents of binaries cite several advantages. First, they like the weekly payout. Since it is a series of two leg matrices, it is simple to explain. Group cooperation is promoted because payout is on group volume and requires balancing of volume in each leg to be eligible for payout. Some call it more democratic because of the limitation on payout in each matrix, the unlimited depth of payout, and the allowance of looping or re-entry.

On the other hand, the binary is the most controversial of plans. The binary had its unfortunate origins in the early 1990s in fraudulent gold coin programs, and its use later for other questionable products did not help. Those subsequent products were generally high-ticket one-time purchases such as consumer service or travel memberships, travel certificates or overpriced prepaid phone cards. By the end of the 1990s, and after many legal challenges, the binary was not in great favor, and only companies like USANA, that had applied the concept to consumables, seemed to be around.

Critics charged that the implementation of binary plans brought on legal and business problems. Companies and distributors tended to promote the plan rather than the product, creating accusations of a "money game." Often plans had a one-time sale requirement which created a something-for-nothing atmosphere and appearance of payment for headhunting recruitment. The multiple business center approach was often presented as a "purchase of a business center," an "investment," or a "front-load" of product. The ability to stack personal business centers also created the possibility of front-loading. The required balancing of sales volume between legs meant that hard work might yield no payoff and income would be forfeited, because personal production did not count if balanced sales volume did not occur. Finally, the multiple re-entry or looping created a "game-like" atmosphere in which an individual could end up in the downline of someone he or she had sponsored. For the distributor looking long term at a distributorship that might be sold, this "looping" also made it virtually impossible to place a value on a distributorship because no continuous downline genealogy could exist.

Last But Not Least

Here are some final yet important aspects of a compensation plan to check out:

Overall Payout

How much of the sales dollar does the compensation plan pay out to its distributors? Most plans pay between 35 and 45 percent of the company's wholesale purchase volume, and about 30 percent of suggested retail volume. Look for a plan that divides the pie in your favor, without going overboard. A plan that is overly "generous" to its distributors can run itself into financial ruin. And that's bad for everyone.

Orphan Commissions

When distributors fail to qualify to earn the commissions or bonuses on their purchase volume in a given month (usually because they fall short of the minimum purchase qualifying amount), the commissions they would otherwise

have earned are called "orphan" commissions. Avoid plans in which orphan commissions return to the company. A plan should be structured in a way that orphan commissions "roll up" to the next qualifying distributor that month, rather than return to the company. This approach is also called "compression." Orphan commissions from terminated distributors should be handled the same way.

Lock-In

Look for a plan that has the lock-in feature; that is, when you reach a certain level, you "lock in" and cannot be demoted because of a temporary drop in monthly performance.

Other Perks

The compensation plans of most companies offer at least some perks for top performance above and beyond commissions and bonuses. These come in many forms: company cars, health insurance, free training, lead and co-op advertising programs. A few publicly traded companies even offer stock or stock options.

No matter what other advantages a plan might have, always ask this pivotal question: "Does it emphasize getting products or services into the hands of consumers; or does it emphasize making money by finding new recruits? If it falls into the latter category, run away — fast. In the end, says White, it's the product — not the compensation plan — that drives success.

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Jeffrey A. Babener, the principal attorney in the Portland, Oregon law firm of Babener & Associates, represents many of the leading direct selling companies in the United States and abroad.

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~ Mary & Jenny “The Sisters” ~