Pyramid schemes

In this type of fraud, the consumer pays a given sum to an entity in the hope of earning multiples of the sum invested. For this scheme to work, he or she must persuade a number of other consumers to pay the same amount to the entity in question. All the consumers taken together make up the pyramid. The higher a consumer rises in the pyramid structure, the greater the chance that he or she can earn a great deal of money.

As in the case of Ponzi schemes, fraudsters are discovered once too few new investors join.

Concretely, the way pyramid schemes handle investments is as follows: the initiator of the pyramid offers potential investors the opportunity to make an investment that promises a very attractive yield, far above the market rate. The initiator thus receives the first payments from investors who have been taken in by the prospect of a high profit. Contrary to what the investors were promised, their money is never actually invested. Rather, the investors are asked to bring in new investors and are promised increased profit if they do so. New investors who enter the system bring in money, which once again is not invested but used in part to pay returns to the first investors. In this way, the pyramid gradually grows, and as long as new investors enter the system, those on the highest rungs of the pyramid continue to receive money. The growth cannot go on indefinitely, however. If the bottom rungs of the pyramid are no longer able to recruit new members, the pyramid collapses. Once that happens, most investors will never be able to recover (all or part) of their initial investment.

When consumers participating in a pyramid scheme can earn money on their initial investment as a result of their having recruited new consumers to join the scheme rather than from the sale or use of products, this constitutes an unfair business practice. Consumers who participate in pyramid schemes not only risk losing their money but are also accessories to a criminal offence.

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