

MARRIOTT

ALUMNI MAGAZINE



Wounding the Giants

How to Spot a Ponzi

The Making of George Romney



ACCOUNTING PROGRAM RANKS THIRD IN *U.S. NEWS & WORLD REPORT*

The Marriott School's accounting program ranked third and its international business program ranked nineteenth in specialty categories in *U.S. News & World Report's* "America's Best Colleges" survey, up from fifth and twenty-first respectively in 2006.

"We are extremely pleased by the recognition our program receives in *U.S. News & World Report*," says Kevin Stocks, director of the School of Accountancy. "We feel our accounting curriculum is very innovative, our students are bright and willing to work, and our faculty members are among the best in the country."

Also, the Marriott School's undergraduate program is numbered among the top fifty in "Best Business Programs," ranking thirty-eighth overall.

The survey ranks about 1,400 four-year accredited colleges and universities by mission and region. BYU is counted among "national universities" that offer a full range of undergraduate majors as well as master's and doctoral degrees.

BYU ranked seventy-ninth overall, twenty-sixth in the "Great Schools, Great Prices" category, and sixteenth in the "Least Debt" category.

Princeton topped the overall rankings, followed by Harvard, Yale, Stanford, and Caltech.

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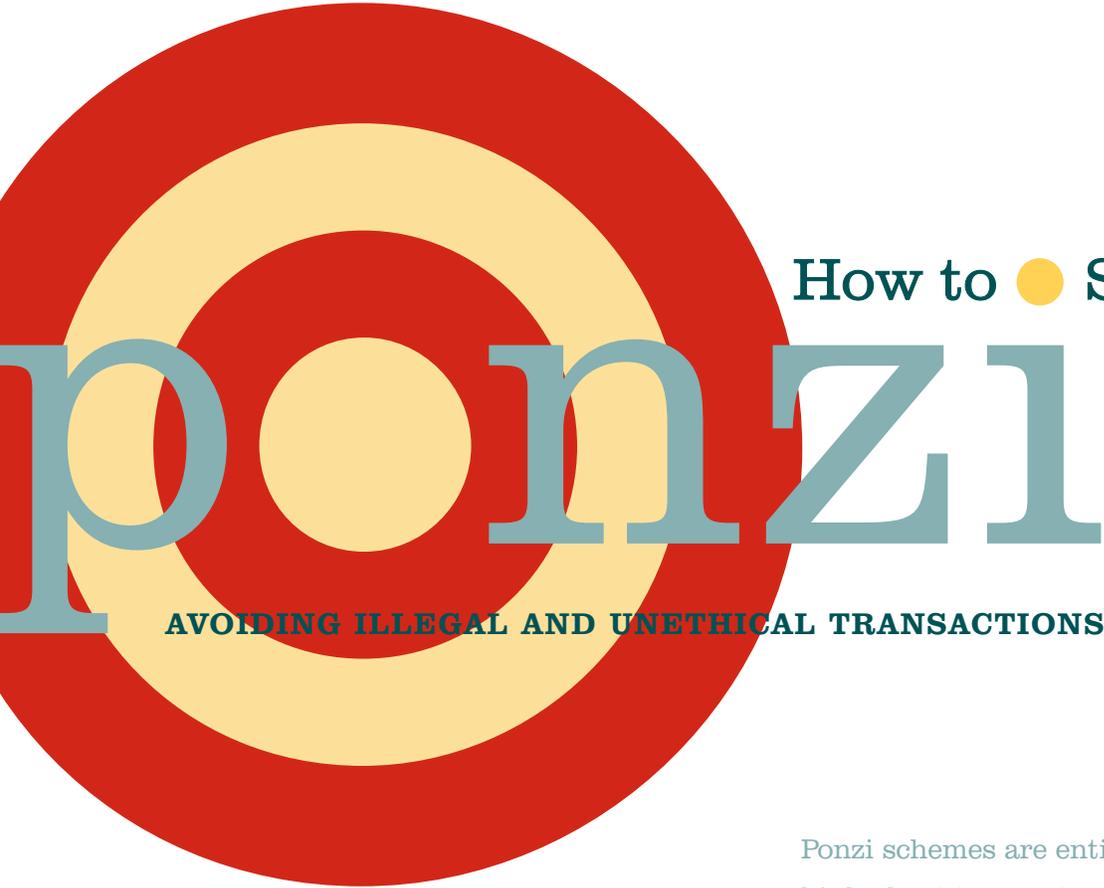
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Visit *Marriott Alumni Magazine* online at marriottmag.byu.edu

Cover photo by Bradley Slade.



How to ● Spot a

ponzi

AVOIDING ILLEGAL AND UNETHICAL TRANSACTIONS

Ponzi schemes are enticing. They offer abnormally high short-term returns but require an ever-increasing flow of money to keep going. They are also illegal and result in the vast majority of investors losing their shirts and maybe more.

By Ned C. Hill ● Illustrations by Adrian D'Alimonte



PONZI

INC.

In January 2006 a student came into my office and handed me a card he had found in the Tanner Building advertising a company called 12 Daily Pro. He said somebody had been distributing these cards around the building, encouraging students to invest in a “business opportunity.” It suggested that you could invest \$6 to \$6,000 and earn a 44 percent return in twelve days (that compounds to 5.6 million percent annual return). I thought that was quite generous compared to the stock market, which averages only around an 11 percent long-term annual return.

THE WORKINGS OF A SCHEME

The card called this program a “new economic paradigm.” I thought to myself, that was probably all you’d be left with after you invested in this scheme—a pair of dimes. I figured this probably was a Ponzi scheme. A Ponzi scheme starts out with one person

or organization at the top. That person promises a great rate of return on investments and gets a couple of other people to invest their money. The key to Ponzi schemes is that the returns come from new investors and not from any real economic activity. You’ve got to get more people to join and contribute their money to the previous investors, expanding from the top down like a pyramid. It has to grow quite rapidly or the promised returns cannot be paid and the whole scheme falls apart.

Deciding to warn our students and faculty, I sent an email to all throughout the Marriott School reminding them that such schemes are illegal, unethical, and immoral. The next day a local TV channel carried the story, and the following day the electronic payment service for the scheme froze all the company’s accounts and essentially shut them down. A few weeks later the SEC filed a securities fraud charge against the head

of the company and against the company itself, calling it a Ponzi scheme. It wasn’t long before the wheels came off.

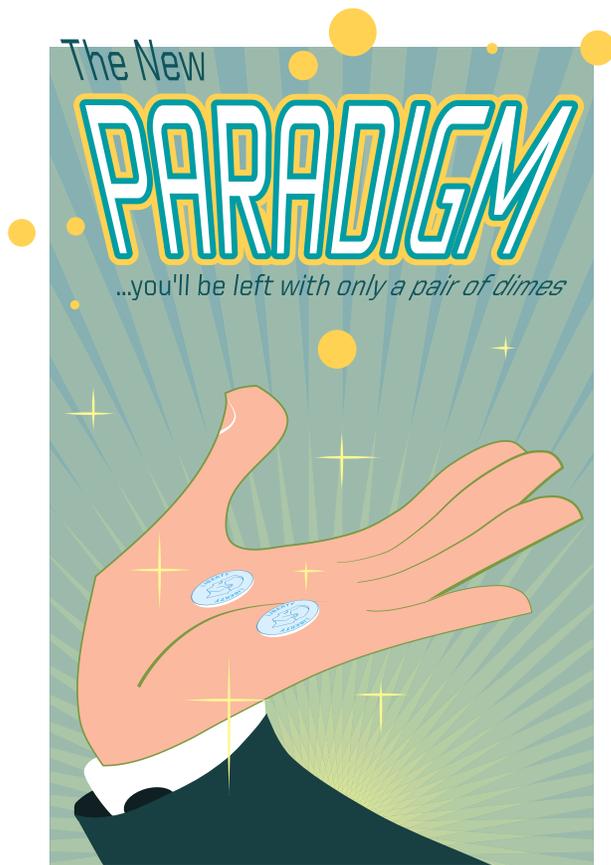
MEET MR. PONZI

Ponzi schemes began with an immigrant from Italy named Charles Ponzi. He was born in 1882 and worked various odd jobs before he decided to start a magazine in 1919. While corresponding with someone in Spain, he realized that letters from Spain that included a postage coupon for the reply letter could be turned into the U.S. Post Office for stamps. One postal reply coupon in Spain cost \$.01, but it was worth \$.06 of stamps in the United States. That was Ponzi’s “investment.” He made an announcement about his plan, promising investors a 50 percent rate of return in ninety days. He actually delivered returns to his first investors in forty-five days. In all, he received about \$15 million from investors—a huge amount of money back then.

Ponzi became one of the most reputable citizens in Boston in that year, touted as one of the brilliant financial minds. Unfortunately, he wasn’t making money with those stamps at all. Having people buy stamps in Spain and sending them stateside was too much trouble. It was much simpler to give investors their return from the investment of newer investors and repeat the cycle as more money came in. The whole scheme fell apart in 1920, and he was arrested, convicted of fraud, and sentenced to twelve to fourteen years in prison. During a prison transfer he escaped, went to Florida, and started selling underwater land as property developments. He was arrested again and eventually deported back to Italy, where he died. But his legacy is very much alive and well and burgeoning on the Internet to dimensions Mr. Ponzi never imagined.

EVALUATING ECONOMICS AND ETHICS

There are some things that can help you determine whether a company is a sound investment. In economics there is a principle called the risk-return trade-off. When there is high risk, you expect to be compensated with a higher return. But if you put your money in a very low-risk federally insured savings account in a bank, you should expect a very low return. If you put it in the stock market, you can expect





In today's world, schemes can originate anywhere at a very low cost and spread rapidly over the globe.

Tracing anything back to the perpetrator is almost impossible. All of this makes these kinds of scams even more dangerous.

a higher return. The recent Ponzi scheme promised the equivalent of a 5.6 million percent annual rate of return. What should that tell us about the risk involved? It would be enormous!

Investors need to be given the opportunity to assess the risk that's involved in any contemplated investment. Were the investors in this scheme, for example, able to assess the risks adequately? Were the risks thoroughly communicated? Of course, the answer was no. The 12 Daily Pro web site failed to point out the source(s) of this handsome return nor did it explain that when the supply of gullible investors ran out, everyone left in the scheme would lose all their money.

What about some of the ethical principles involved in these companies? Honesty is the basic foundation of all ethical principles and behavior, and it was nowhere to be found in this example. Nobody mentioned this was a potential Ponzi scheme. The marketing information simply talked about a great "business opportunity" with an amazing return. The information was not honest nor fair to investors—especially the less-informed. In the end, the scheme did not create wealth—it just transferred wealth from the gullible to the clever and dishonest.

In today's world, schemes like these can originate anywhere at a very low cost and spread rapidly over the globe. Tracing anything back to the perpetrator is almost

impossible. All of this makes these kinds of scams even more dangerous. I've composed my own list of the top ten types of scams.

1. *Easy Business Opportunities*

The most common one is the "easy business opportunity." The pitch is: little or no work involved, a great income, little cash outlay, the ability to work at home, and other similar promises. Most are really pyramid schemes or problematic businesses that aren't really an opportunity at all—they're a way to transfer money from your pocket to someone else's.

I conducted an online search for "make money fast" and got three million responses. One I pulled off, Mobile e-Cash, said, "Set up your business in two hours. Make \$11,000 a month. It's not multilevel marketing; it's not gifting or chain letters." The web site doesn't ever say how you're going to make the money, even though it's guaranteed. The site claims that if you send \$57.97 you will receive a package that will help you make \$15,239.97. They have it down to the penny.

2. *Work-at-Home Schemes*

I've known many stay-at-home spouses

who wanted to support the other spouse in school, so they looked into work-at-home programs. An example is Netdata Solutions. If you send in \$485, they send you a software package and a list of doctors in your area who need medical billing services. With this software, doctors supposedly send you patient bills that you then bill to the insurance company. However, the Federal Trade Commission found that the training was inadequate; it didn't really explain the complexities of medical billing. The software was virtually unusable, and the doctors on the list did not actually need the service. Many people lost a lot of money.

3. *A Miracle Cure*

Search for "lose weight effortlessly" or "cure hair loss" online, and you'll get tens of thousands of web sites. They claim scientific breakthroughs, but most simply don't work—and some are actually harmful. They promise miracle cures, but usually they include nothing more than a CD or audio download that costs a lot of money.

4. *Corrupt Sales Scams*

We've seen our share of sales scams where the pricing is too good to be true, and the

operation is usually run through network marketing. A few years ago, kids came through Provo neighborhoods selling, on behalf of high schools, coupons that cost \$30, which allowed you to receive thirty boxes of cereal delivered to your home. That sounded too good to be true. Cereal at the grocery store costs \$3 to \$4 per box—so how could you buy something for a dollar and have it delivered to your house?

It turned out the distributors bought the coupons from the originator for \$13 per sheet, the schools bought the coupons for \$17, and the students sold them to consumers for \$30. Sure enough, the cereal did get delivered for the first two or three weeks, but then there were no more deliveries. The coupon holders called the originator, but the firm was nowhere to be found.

5. Chain Letters

I mention chain letters because they are an old way to scam people. But now with email they can be done a lot faster and a lot more effectively. The idea is that you receive a letter asking for a small amount of money—\$5 or \$10—to be sent to the top five people on an attached list. You then remove the top one, add your name to the list, send it on to five more friends, and you'll get \$15 or \$25 in return, and it will go on and on while you make lots of money in the process. Chain letters are illegal, and nearly everyone who participates loses money. Sometimes they involve a product like a recipe to try to get around the chain letter law, but they're still illegal.

6. Investment Seminars

Another one of my favorite schemes is investment seminars. Some of them are actually legitimate, but they're few and far between. The idea here is to get rich using certain "secrets" only available from the organization that knows "how the markets really work." There was one famous seminar that claimed to show how previous seminar participants were making money online using these "secrets." Unfortunately, the transactions were bogus.

The cost of these seminars usually starts out small, but to really learn the "good stuff" you normally have to pay thousands of dollars for additional training. Often, the investments they suggest are high-risk and high-leverage that are probably not the best

for most of us. Many are based on old techniques that may or may not have worked well in the past. Usually, the only people making money in these kinds of things are the people who run the seminars, not the people who attend them.

7. Gone Phishing

One thing you need to worry about—and I include this not because it's an investment scheme but because it severely damages you—is phishing. Almost everybody has received a phishing request. You might get it in an email saying your bank account has been frozen or your investment account has been compromised. The email asks you to click on a log-in icon and then verify your account information, personal identification numbers, and even passwords.

The web site might look legitimate and might look just like your bank or investment firm's web site. However, underneath is another web site, and the information you enter is transferred somewhere else where it is gathered by people who will rob you blind. This happens quickly, and it is very hard to get the problem fixed. A related scheme, called pharming, embeds virus-like programs into your computer,

stealing your account and log-in information when you enter it online.

8. Charity Cases

Who has not received a desperate email plea from some faraway country? It always contains some kind of sad story designed to win your sympathies and induce you to send them money. They eventually ask for your bank account information so you can help them transfer money for some charitable cause or another—for which you will be richly rewarded. Be careful.

9. Commodities

In troubled economic times, commodity prices tend to fluctuate, and "you can make good money in these markets." I don't know if anybody can regularly make good profits in the commodities market, because they are exceptionally risky. When you enter into futures contracts you can lose not only your original investment but much more. It's true that commodities or currencies do fluctuate, but the fluctuation is very difficult to predict. So when you hear commodities like oil futures being advertised on the radio to the common consumer, realize it's a very risky proposition.

Protect confidential information.
Apply the tests of economic
and ethical principles to any
potential investment, and
speak out when you see things
that are unethical or illegal.

10. Multilevel Marketing

I'm not against multilevel marketing programs per se. But sometimes important information and risks are not disclosed adequately. Marketing materials claim "this is a great way to make easy money with proven programs that offer great returns—with products that practically sell themselves."

The reality is that success in a multilevel marketing program is very difficult for most people to achieve. In fact, a very high percentage of those people lose money. The risks are sometimes not spelled out, or the products may not be what they claim to be.

This isn't an indictment of all multilevel marketers. There are some who follow through very well and disclose risks. But if you find that most of the product is bought by distributors, that's not a good sign. What is the product they're selling? Is it really worth something in the marketplace? Is the price reasonable? You should ask these and other questions when confronted with a multilevel marketing program.

SNIFFING OUT A SCAM

There are questions you want to ask when confronted with any business proposition.

- Is the promised return unusually high? Remember the risk-return trade-off—if somebody promises you a high return, there's also a high risk.

- Is the price of the product relative to the normal market price? Often a scam will price its product significantly above or below a reasonable market price. Either way, that should be a red flag.

- Does the sale require pressure tactics? If you have to buy it before sundown, you know something is wrong.

- Do you have to have a special connection with the seller through church, a club, or social network?

- Does the seller have a good reputation?

There are many ways to find out about the kinds of schemes that may lure you. A good place to start is the Federal Trade Commission. It keeps track of the latest schemes and scams and publishes online information about them at: www.ftc.gov/bcp/menus/consumer/invest/schemes.shtm.

Teach your family and friends about avoiding scams. Protect confidential infor-

mation. Apply the tests of economic and ethical principles to any potential investment, and speak out when you see things that are unethical or illegal.

The overriding principle here is to make sure your financial foundation is solid, which is something these scams can't provide. Make sure you have things like adequate health and life insurance. You ought to have enough stored in mutual funds or in savings accounts to last you at least three months, so that if adversity comes along, you're protected. Make sure you have a home, which is one of your best investments, and a checking account that doesn't bounce checks. Take advantage of tax-deferred investments, retirement plans, and similar products before you start doing other things.

I hope that all of us will protect ourselves against the myriad schemes that confront us and our families with ever-increasing frequency. They may very well prove disastrous to your financial foundation. **M**

ABOUT THE SPEAKER

Ned C. Hill is dean of the Marriott School of Management. This text is adapted from his presentation at the Marriott School's Management Conference 29 June 2006.

