September 25, 2012

Executive Summary

With economic development and growing consumerism, the retail and FMCG sector in India has undergone significant changes. Various business models and retail formats have evolved to cater to this growing market. Direct selling is one such distinct business distribution model. They produce products like any other FMCG player in the country. However, the distinction arises only by the way they reach to the consumer.

Direct Selling business found its way into India almost two decades ago, in the early nineties, when the Government of India permitted a few foreign companies to operate their business as per the law of land. Being a new kind of business, entering for the first time in to Indian society, no one in the government knew its dynamics and rules-regulations.

This paper is an attempt to understand the Direct Selling Model in India and deliberate on the benefits it has brought to the society; at the same time analyzing the challenges that the Industry is currently facing.

The paper would focus on following aspects:

Understanding Direct Selling Distribution Model:

Direct selling is a sales and distribution channel/system whereby, on the basis of certain well defined rules direct sellers can derive income not only from personal sales but also from ongoing sales and consumption by people whom they, directly or indirectly, have introduced to the direct selling company and for whom they provide ongoing motivation and training. This sector is one of the fastest growing non-store retail formats, recording double-digit growth in the post-reform period.

How Direct Selling is Different from Traditional Retail Selling:

Direct selling is different from traditional retail sales activity. Unlike traditional retailers who serve a customer who comes to the retail stores/outlets, the direct seller does not wait until a customer approaches him/her, instead takes proactive steps to offer and explain or demonstrate the products to potential customers. Direct selling is a sales method based on personal contacts with customers both before (presentation of the product) and after (follow up contacts) the sale.

Most sales take place on the basis of informal contacts: Mostly customer base are often made on the basis of referrals from other customers. The sale of products in the framework of a direct selling system requires many personal contacts between the distributor and his customer. For obvious reasons of both time constraints and geographical limitations, an individual distributor can only serve a limited number

of customers personally. If an individual distributor wants to make its products available to a larger range of customers, he can enlist the help of other sales person for whom he will act as a mentor and a coach on an ongoing basis. This enlisting and supporting other distributors is the decision of the distributor – and of the distributor only – depending on whether he/she wants to engage in business activities and what scale of activity he/she wants to develop. If the desired market is too large for one single distributor to achieve, the active participation of others can be enlisted, just as this is the case in a retail store/outlet sales/distribution system where additional shops would be opened.

Benefits of Direct Selling Distribution Model:

a) *Increase in Employment Opportunities:* Direct selling offers self-employment opportunities to a large number of people, especially women.

The number of direct sellers in India has almost doubled between 2004 and 2009. In terms of the number of direct sellers, India ranked 11th among the top direct selling countries in 2009-10. In future, this sector is expected to offer employment opportunities not only in urban areas but also in rural areas. Indirect employment is expected to be generated in manufacturing and the supply chain, as direct selling companies develop India as a sourcing hub.

Research has also found out that direct selling has developed them to build self-esteem and confidence and develop their sales skills. It has enabled women to be financially independent and increased their ability to save. Direct selling also provided a safety net during the global slowdown as a large number of direct sellers joined this sector during that time.

In fact, the number of direct sellers increased by 4.84 per cent during the slowdown period (2008-10).
An interesting finding of the researches is that although, direct selling has benefited women in terms of financial independence and improved self-esteem, Indian women, unlike women in other countries, do not think that they have achieved equality of status with men. The flexible working hours that direct selling offers has helped women achieve a balance between their work and family lives.

b) Increase in investments: the huge investments that the foreign direct selling companies have brought into India have further contributed to the GDP of the economy.

c) Positive impact on Small and Medium enterprises: Researches have also found that direct selling companies are investing in setting up manufacturing units in India and are streamlining the supply chain. A substantial part of the products are sourced locally from contract manufacturers and this is leading to the percolation of technology, the concept of branding and packaging, etc., to Indian small and medium enterprises (SMEs).

d) Financial independence, development of personal and business skills, flexible timings and an improved ability to take care of families is other benefits of direct selling.

Key Challenges of Direct Marketing:

a) Absence of clear definition of Direct Marketing

b) Absence of a separate regulation for the sector

c) Easy Market entry: Entry of nonprofessional people into Business hampering the image of the genuine players

Need of Awareness about the Sector

Direct Marketing needs more recognition in India and the myths about its model needs to be cleared. It is a pure business form and the income is earned on the basis of direct sales. A widespread awareness is required to increase its acceptability amongst every stakeholder.



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INTRODUCTION

Overview of Direct Selling Industry in India

Direct selling can best be described as the marketing of products and services directly to consumers in a face to face manner, generally in their homes or the homes of others, at their workplace and other places away from permanent retail locations. Direct sales typically occur through explanation or personal demonstration by an independent direct salesperson. These salespersons are commonly referred to as direct sellers.

The strength of direct selling lies in its tradition of independence, service to consumers, and commitment to entrepreneurial growth in the free market system. Direct selling provides accessible business opportunities to people looking for alternative sources of income, and whose entry is generally not restricted by gender, age, education, or previous experience. It should be noted that around the world a substantial majority of direct sellers are women, and most work in the direct selling business on a part-time basis. A very small percentage of direct sellers are employees of the companies whose products they sell.

Independent direct sellers are those individuals engaged on their own behalf, or on behalf of a direct selling company, selling products and services through personal sales contacts, and are commonly referred to in some jurisdictions as independent contractors. Essentially, this means that these independent salespersons are not employed by the company whose products they distribute, but are independent business persons operating their own businesses. These independent direct sellers have an opportunity to earn profits from their business, and also accept the responsibility for the risks associated with operating a business.

The products sold by direct sellers are as diverse as the people themselves and include: cosmetics and skin care products; laundry and personal care items; vacuum cleaners and home appliances; household specialties; household cleaning products; food and nutrition products; toys, books and educational products; and clothing, jewellery and fashion accessories; just to mention a few.

Generally, these products are sold in the context of group presentations (Party Plan), or on a person to person basis (one-to-one). In a Party Plan approach, the direct salesperson demonstrates products to a group of guests, invited by a host in whose home or other location the direct selling demonstration takes place. By contrast, other direct sellers will often explain and demonstrate the products they offer to consumers in the comfort of the consumers' homes, at a time which is convenient for them.

Growth of Direct Selling in India

Direct selling distribution channel in India is one of the emerging avenues of growth for various industries especially FMCG sector. The Indian direct selling industry has scaled remarkable growth over the years and has been expanding its horizons in India as a rapidly emerging alternate distribution channel. Many Indian and multinational direct sellers have started operations in India through joint ventures or wholly-owned subsidiaries

In 2010-11, the sales of numerous direct selling companies in India were estimated at Rs 5,229 crore. The total distributor base of the direct selling business in India in 2010-11 was 39.62 lakh people. Though the growth of the industry varies across its different segments like organized and unorganized sections, overall the industry is slated to grow at an average of more than 20 per cent in the next four years. Direct selling business in India is expected to reach a size of Rs 10,843 crore by 2014-15 on the back of increased consumer spending.

Giving a snapshot of growth rates of direct selling industry, overall, the direct selling industry grew by 27% in 2010-11 as compared to 17% in 2009-10. The turnover in the Northern region moved from 12% in 2009-10 to 15% in 2010-11, on the contrary, average sales turnover of Southern region has declined from 48% in 2009-10 to 44% in 2010-11. Total distributor base reported 24% growth. Wellness has emerged as a leading product category contributing to the highest share of sales (40%) followed by cosmetics and personal care products (32%).

The growth in tax collection from the direct selling firms has jumped to 58% in 2010-11 from 11% 2009-10 and 18% in 2008-09. Around 65% products are sourced through contract manufacturers which are SMEs; contributing largely to the growth of Indian SME sector.

Recently, a trend is being observed wherein the Established retail have also started direct selling operations, the most prominent being Hindustan Lever Limited of the Unilever group, Avon Beauty Products India Pvt. Ltd, Oriflame India Pvt. Ltd. and Mary Kay Cosmetics India Pvt. Ltd.

Direct Selling & Traditional Retail Channel

Direct Selling and the traditional Retail Trade channel have several similarities and differences which are given below:

Retail Trade	Direct Selling
Product and brand awareness created by Company and product made available at retail outlets by Company for consumers to purchase	Product and brand awareness created by Distributor and product made available to the consumer through the same distributor
Company pays people to sell the product by providing retail margin to the retail outlets	Company provides retail margin to the Distributor and also pays volume based commission to the selling Distributors
Company manages the retail outlets and motivates them by providing them extra incentives to promote their product	Company manages the Distributors and motivates them by paying extra commissions on achieving higher sales of products
Sale occurs at a fixed outlet	Sale occurs normally at the consumer's home
Sales growth depends on coverage of retail outlet	Sales growth depends on number of Distributors. Hence increasing the no. of distributors and their management is important to the Company
No training provided to retail outlets	Company trains the Distributors on product benefits & claims to create unique brand experience during sale to end consumer

Direct Selling provides accessible business opportunities to people looking for alternative but legal sources of income, and where entry to the business is generally not restricted by financial ability, gender, age, education, or previous experience. Survey indicates that most persons engaged in the Direct Selling work on a part-time basis and nearly 60% of them are "Women". These Distributors have

an opportunity to earn profits from their business of selling goods/services and also accept the responsibility for the risks associated with operating a business.

Key Benefits of Direct Selling Distribution Model:

b) *Increase in Employment Opportunities:* Direct selling offers self-employment opportunities to a large number of people, especially women.

The number of direct sellers in India has almost doubled between 2004 and 2009. In terms of the number of direct sellers, India ranked 11th among the top direct selling countries in 2009-10. In future, this sector is expected to offer employment opportunities not only in urban areas but also in rural areas. Indirect employment is expected to be generated in manufacturing and the supply chain, as direct selling companies develop India as a sourcing hub.

Research has also found out that direct selling has developed them to build self-esteem and confidence and develop their sales skills. It has enabled women to be financially independent and increased their ability to save. Direct selling also provided a safety net during the global slowdown as a large number of direct sellers joined this sector during that time.

In fact, the number of direct sellers increased by 4.84 per cent during the slowdown period (2008-10).
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b) Increase in investments: the huge investments that the foreign direct selling companies have brought into India have further contributed to the GDP of the economy.

c) Positive impact on Small and Medium enterprises: Researches have also found that direct selling companies are investing in setting up manufacturing units in India and are streamlining the supply chain. A substantial part of the products are sourced locally from contract manufacturers and this is leading to the percolation of technology, the concept of branding and packaging, etc., to Indian small and medium enterprises (SMEs).

d) Financial independence, development of personal and business skills, flexible timings and an improved ability to take care of families is other benefits of direct selling.

e) Revenue for the exchequer: Direct Marketing companies have contributed a lot to bring the common public in tax net and banking channels; thus have contributed significantly to a national cause.

- All individuals get commissions only through banking channel.

- Thus a huge number of individuals getting commissions in lieu of the sales done through them have opened their bank accounts and have been added in banking channel.

- Equal numbers of individuals have been added in income tax PAN data.

Key Challenges of Direct Selling Industry

a) Absence of clear definition of Direct Marketing

b) Absence of a separate regulation for the sector

c) Easy Market entry: Entry of nonprofessional people into Business hampering the image of the genuine players.

Considering the immense potential of Direct selling in India and the challenges faced by this sector, FICCI has taken the initiative of organizing a knowledge seminar on the new growth avenues for distribution.

This Seminar is an attempt to understand the Direct Selling Model in India and deliberate on the benefits it has brought to the society; at the same time analyzing the challenges that the Industry is currently facing.

Annex I– Summary Information on Direct Selling Laws and Regulations

Cooling Off Period: The time allowed for a new distributor to cancel the contract and return inventory for a refund on inventory and registration fee.

3 business days – United States

5 business days – Argentina, Mexico, South Africa

7 Day – Korea (Single Level), Austria, Denmark, Finland, Germany, Hong Kong,

Ireland, Netherlands, New Zealand, Russia, Singapore, Spain, Turkey, United Kingdom, Belgium, Brazil

8 Day – Japan, Hungary

10 Day – Australia, Canada, Italy, Malaysia, Norway, Chile

14 Day – Czech Republic, Lithuania, Sweden, Taiwan, Ukraine

Longer – Korea (MLM only), Japan (MLM only),

Anti-Pyramid Scheme: Law or regulation banning trading schemes that compensate participants for the act of recruiting new participants.

Australia, Brazil, Canada, Finland, France, Germany, Hong Kong, Hungary, Ireland, Italy, Japan, Malaysia, Netherlands, New Zealand, Norway, Philippines, Singapore, South Africa, Spain, Taiwan, United Kingdom, United States

Specific MLM Provisions: Laws containing various provisions regarding prohibited practices, refund requirements and product returns.

Canada, France, Indonesia, New Zealand, South Africa, Spain, Certain states in the United States (Georgia, Louisiana, Maryland, Massachusetts, Wyoming, Montana, Commonwealth of Puerto Rico)

Credit Restrictions: Companies to obtain licenses to provide credit to distributors- Australia, Ireland.

Countries requiring full disclosure of credit terms before providing credit: Austria, Canada, Chile, Denmark, Finland, France, Germany, Italy, Lithuania, Mexico, Netherlands, New Zealand, Philippines, Singapore, South Africa, Spain, Taiwan, Turkey, Ukraine, United Kingdom.

Credit Bans: Laws banning the use of credit for inventory purchases.

Japan (However, Japan allows the use of installment sales in some cases.)

License Requirements (Company): Companies must hold a direct selling license.

Austria, Belgium, Canada, Czech Republic, Malaysia, Turkey.

License Requirement (Distributor): Distributor must hold a license or be registered.
Germany, Italy, Japan, South Korea, Spain, United Kingdom.

Earnings Claims: Company must publish information on average distributor earnings:

Canada, Ireland, New Zealand, South Africa, Taiwan, United Kingdom (if claims are made), Singapore (in all cases).

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Annex 2 Direct Selling Laws around the World

This paper discusses the legal framework for regulating direct selling, a distribution system used by certain companies in which they engage private citizens to sell their products to consumers and, in many cases, provide a number of other support services to the company. The paper is divided into nine sections, as follows:

I. Introduction
II. Definition of Terms.
III. Protecting Consumers of an Unregulated Investment
IV. Countering High Pressure Sales Techniques
V. Banning Pyramid Schemes and Permitting MLM Compensation
VI. China and WTO Trends
VII. Enforcement
VIII. Issues Not Addressed in Law
IX. General Principles and Summary

I – Introduction

Direct selling has the potential to give citizens an earning opportunity without regard to their background, education level, gender or physical handicap. Worldwide, more than 58 million people engage in direct selling and the industry revenues for 2007 exceeded US$109 billion. Protecting those who invest in a direct selling business is crucial to the success of the industry and to economic progress for those who invest in these businesses. All companies have contract rules that protect distributors, consumers and the company's good name. National laws work best when they create a partnership between governments and companies to enhance enforcement of the rules in these contracts. National laws that effectively protect distributors typically require that companies include clear and workable rules in their contracts.

A well regulated direct selling industry offers several benefits to a developing country. It gives an opportunity to people of limited means to earn the money needed to improve their lives. It also helps them develop sales, marketing and management skills to contribute to the advancement of the country. We recognize that we cannot prosper in India unless India and those who work with us there prosper. We sincerely hope to work with the all concerned to develop regulations for India that contribute to India's economic development and success of Indian citizens who engage in direct selling.

II – Definition of Terms

There are three key elements to direct selling.

1. The distributor is usually an independent of the company and not an employee. Thus, the distributor is able to set his or her schedule, retail price and level of effort. In a very few countries, a distributor is an agent of the company and not able to adjust prices, but this requirement is uncommon.
2. The relationship between the company and the distributor is typically governed by a contract that specifies the obligations of each party and means of compensation. This contract contains rules that are enforced by the company and that provide the primary level of protection to customers of the distributor.
3. The investment in a direct selling business is typically quite small, almost always below the threshold that triggers requirements to register the business opportunity as a security or limit the offering to wealthy investors.

There are two elements that are quite common in direct selling but not necessarily uniform to all direct selling companies.

1. Quite frequently, the company pledges that it will not compete with the distributor by selling the products through any other sales channel. This assures the distributor that the company will not undercut his or her sales efforts.
2. In many cases, direct selling companies ask distributors to provide market development and other sales-support services to the company. Companies compensate distributors for the value of this service with payments based upon the value of additional goods or services sold by the company.

Distributors earn a profit in two ways. First, they are entitled to the margin between the wholesale and retail prices of the products that they buy and then sell. Second, almost all companies pay them an extra bonus when sales volumes hit certain levels. Much of the difficulty in regulating direct selling centers on these bonus payments. Companies encourage distributors to recruit their customers to become distributors as well and compensate the primary (or "up-line") distributor when his recruit (or "down-line") makes additional sales, assuming that the aggregate volume hits a pre-determined level.

These compensation programs have various names ranging from "leadership programs" to "marketing consultants," but the most common descriptions are "network marketing" and "multi-level marketing" (hereafter referred to only as MLM). Payments under MLM compensation programs recognize both that the company received a valuable service from the distributor that generated additional sales and that this distributor's efforts in this regard could result in a reduction of his income as his customer is now a distributor as well. Thus, one of the most critical aspects of regulation is to establish a system that recognizes the economic benefit of MLM operations and provides partial compensation to the up-

line distributor for sales generated by his down-line distributors. Linking compensation to product sales ensures that an MLM program is not a disguised pyramid or money circulation scheme. Section V of this paper addresses this issue in detail.

III – Protecting Consumers of an Unregulated Investment

Before discussing the specifics of direct selling laws, it should be noted that investment in a direct selling business is typically quite small. U.S. business opportunity laws governing such investments at the state level typically require extensive disclosure and registration obligations when the amount solicited exceeds US$500. Many countries use similar figures as thresholds for regulating investment opportunities. Interestingly, the European Union exempts all investments under €60 from all regulations.

As a point of fact, Amway and many other direct selling companies sell starter kits to distributors that contain some inventory. While this varies from country to country and is driven by market conditions in a country, the total investment stays well below the level that triggers the registration of a security. In most markets, Amway's starter kits cost less than US$100, and in some cases less than US$20.

While some companies sell more expensive items, they often operate programs that permit the distributor to sell directly from company inventory to avoid imposing large inventory costs on these small businesses. In some cases, companies extend credit to distributors in order for them to purchase big-ticket items. Germany, the United Kingdom and several other countries where big-ticket sales are common, require companies that use credit for large purchases to obtain special licenses and will revoke those licenses if they find that the credit facility is being abused. By contrast, Japan prohibits the use of credit for inventory purchases.

The Republic of Korea imposes a different standard on direct sellers. Companies may not impose a "burden" on distributors that exceeds 30,000 won, or about US$30. "Burden" is defined as the maximum investment in training and other elements of the business that will not be refunded to the distributor. This applies both to subscriptions to distributor magazines sold by a direct selling company and to training by outside vendors of such materials. As a consequence, companies are vigilant about controlling outside training materials in order to avoid inadvertently triggering issues relating to "burden." This rule does not apply to voluntary inventory purchases or the purchase of goods that can be returned to the company and a refund obtained.

IV – Countering High Pressure Sales Techniques and Inventory Loading

Direct selling grew out of the door-to-door sales industry, as evidenced by the most common element of direct selling regulations: the "cooling-off period," designed to counter the problem of high pressure sales techniques. The cooling-off period allows customers to cancel a contract and receive all of their

money back within a specified time period. Such periods are included in the laws of the United States, almost all member states in the European Union, many countries in Latin America, Japan and Korea.

U.S. Federal Trade Commission (FTC) regulations and laws in all 50 U.S. states require a three-day period in which a contract of US$25 or more to purchase goods or services, or to commit to selling goods or services, may be cancelled in full. The EU standard is seven days but the Czech Republic has extended the period to 14 days. Japan has a 20-day cooling off period. Singapore allows for 60 days. Korea allows distributors in an MLM system to cancel the contract within three full months of its initiation, the longest in the world, but limits the cooling-off period for other contracts to 14 days. These laws also give new distributors ample opportunity to opt out of the contract for a business opportunity and get all or most of their money back.

Ethical companies abide by the World Federation of Direct Selling Associations (WFDSA) Codes of Conduct, which requires them to refund 90 percent of all inventory costs to distributors up to one year after the initiation of the contract, provided that the returned inventory is in salable condition. Nonetheless, these rules do provide a framework for regulation by establishing a clear standard that enables distributors to change their minds and quit if they choose to do so for any reason.

V – Banning Pyramid Schemes and Permitting MLM Compensation

The more challenging aspect of regulation has been to devise language that enables officials to distinguish between legitimate payments for sales support services, such as marketing and building a broad-based distribution system, and payments for unethical activities. Governments have used several different ways to achieve a balance between legitimate MLM payments and those that support an illegitimate pyramid or money circulation scheme.

In Europe, Canada, Australia, Hong Kong and the United States, the laws define and prohibit pyramid schemes as illegal practices. The European Commission Directive on Unfair Commercial Practices lists a number of practices that are considered unfair in all circumstances, including this definition of pyramid schemes that is typical of language in the countries and U.S. states referenced above:

> "(14.) Establishing, operating or promoting a pyramid promotional scheme where a consumer gives consideration for the opportunity to receive compensation that is derived primarily from the introduction of other consumers into the scheme rather than from the sale or consumption of products.

Most EU member states are now adapting their national laws to conform to the directive. It should be noted that at present France bans "snow-ball sales" but does not define the term and Germany bans "progressive selling" with products passed on down a chain from the parent company with a mark-up at

every level. These countries are in the process of adjusting their laws to the EU directive, which they have found corrects deficiencies in their national laws.

In Asia, Japan's Unlimited Chain Scheme Law of 1979 specifically bans "head-hunting" or fees for any purpose other than recognition of sale of products to consumers. Korea, in its Door-to-Door Sales Act (DDSA), recognizes MLM compensation systems while banning payments based on activities "for the expansion of the sales network, rather than the sale of products to the consumer."

Korea also imposes a capital requirement of 500 million won (US$500,000) on MLM companies and obliges them to register their sales contract with the government along with details of the company's systems for inventory management, payment of bonuses, verification of refunds and pay into an insurance fund to cover damages by any MLM company in the country.

Singapore has, perhaps, the most unusual system. It bans MLM compensation unless a company's operation meets certain specific criteria. The criteria are included under an order published in 2000 listing Excluded Schemes and Arrangements to the MLM ban. Chief among these is a prohibition on compensation for the enrollment of participants in a distribution system (head-hunting fees). Singapore also obliges companies to publish detailed information on the amount earned by MLM distributors to ensure that they do not use false information in efforts to induce individuals to enroll in the system. The 60-day refund period noted in Section II applies only to companies that utilize the MLM exception. For non-MLM direct selling companies, the cooling off period is seven days.

In the United States, five states have enacted new anti-pyramid laws using language similar to that used by the EU but that mandate an inventory buy-back and additional consumer protections. This new model law has been enacted in the U.S. states of Georgia, Idaho, South Dakota, Utah and Washington. The law has been included in a compendium of "Suggested State Legislation" by the U.S. Council of State Governments, the leading public policy organization comprised of U.S. state legislators.

The U.S. Federal Trade Commission regulates most direct selling activity under Section 5 of the FTC Act, which permits it to attack fraud whenever it is found. In 2006, the FTC proposed a draft rule on business opportunities. After reviewing public reaction to the proposal, the FTC narrowed the scope of the draft to eliminate direct selling from the new rule. In its amended proposal, the FTC said that "Earnings claims lie at the heart of business opportunity fraud, and are typically the enticement that persuades consumers to invest their money." Nonetheless, it did not impose an earnings-claim requirement in this rulemaking for two reasons. First, the FTC argued that it already has the authority to prosecute false claims under Section 5 of the FTC Act, and that authority gives great flexibility. Second, the FTC could not devise a formula that accommodated the complexity of different MLM earning records.

Making an accurate estimate of earnings is difficult because many distributors do not try to sell and merely join a direct selling company in order to buy products at wholesale. Thus, if developing an "average" means dividing gross bonus payments by the number of registered distributors, the average will be significantly lower than is experienced by "active" distributors. The industry is currently striving to develop an accurate and ethical formula to allow companies to compute an average not diluted by inactive distributors.

VI – China and WTO Trends

The People's Republic of China banned all direct selling in 1998 largely because unethical local companies were cheating unsophisticated Chinese consumers. This led to a considerable degree of social unrest and a rethinking of Chinese authorities about allowing companies to use the direct selling system in a country where free market commerce was reemerging after 50 years of a communist system. Nonetheless, as a condition of its entry into the World Trade Organization, China agreed to allow "sales away from a fixed location" once it had time to devise regulations to govern such sales.

It did so with several requirements that are unique to China. First, direct selling companies must have several years of experience outside of China and paid in capital exceeding 100 million RMB (more than US$6.5 million). Second, they must maintain identifiable physical locations in every jurisdiction where they are licensed to operate so that consumers can return products for refunds. Finally, in most cases, companies may not make MLM payments, which in China are referred to as "group sales," except when a distributor incorporates and signs a contract as an "authorized agent" of the company.

Nonetheless, enforcement authorities in China have allowed licensed companies with a proven track record to designate certain distributors as nominal employees who can be paid marketing bonuses for the services that they provide to companies that result in increased sales. Officials have done this in order to differentiate between the legitimate companies and those small, frequently indigenous companies that continue to cheat unsophisticated citizens. This system has created a new dynamic in the business. Companies are careful in selecting distributors who will be designated as "employees" in contrast to the traditional system in which any distributor could try to build a business.

Following the experience in China, several countries that are home to major direct selling companies began to seek provisions in a WTO context that could standardize an approach to direct selling regulations among member countries. The accession agreements for several countries that entered the WTO after China did address this issue in the General Agreement on Trade in Services section on Distribution Services, using this language:

> "Companies may engage individuals to sell goods and services to the public under standard contract law and may compensate these independent contractors for both sales and sales support services such as marketing."

This issue was raised and generally accepted in the Doha Round of WTO negotiations.

VII – Enforcement

Enforcement issues pose their own challenges for policy makers. In the case of legitimate companies, most problems are caused by distributors who violate company rules and hide the violation from the company. The decision for officials in these cases is to decide when to hold a company liable for the actions of a distributor.

An enforcement action can serve to punish a company or to enhance protection for consumers (including consumers of the business opportunity). In cases where companies have a history of operating ethically, officials typically choose to use the company's contract with the distributor to correct abuse of consumers or down-line distributors by giving the company an opportunity to enforce its rules.

For example, in the United States, officials have developed a system that works quite well. Complaints may be filed in any of the 50 states but are then forwarded to the chief law enforcement officer in the company's home state, usually the state attorney general. Once a company is notified it has up to 30 days to resolve the matter or explain why it has not done so. Quixtar, Amway's U.S. operating company, is proud of the fact that it resolves 99 percent of all such complaints within two weeks.

Germany employs a similar system but complaints from around the Nation are passed to the county where the corporation is registered. Amway Germany has a record of resolving all such complaints within a five day period. Amway has a similar relationship with authorities in Belgium, where a rogue distributor tried to turn the business into one focused solely on recruiting. This level of collaboration, which is highly unusual in Belgium, is described by authorities as a "gentlemen's agreement," which has proven to work quite well.

Using company rules to protect consumers works when a company cooperates. When a company fails to enforce its rules, governments are positioned to punish the company, often by forcing the company to suspend or terminate its operations. Korea's DDSA includes the power to temporarily suspend or close companies. Indonesia and Malaysia each require companies to obtain specific licenses to conduct MLM operations and will withdraw or decline to renew these licenses if a company has failed to compel distributors to adhere to its rules.

In the United States, state and federal regulators always retain the right to investigate and prosecute suspected abusive activity even if it is not illegal. When necessary, abuses are described and corrected in a document know as a "consent decree" or "consent agreement." In accepting such a document, a company undertakes a legal obligation to change its behavior in a specific manner and acknowledges that failing to do so is a violation of law. Subsequent violations – as is the case with any criminal violation – can result in fines and even imprisonment of company officers deemed responsible for the actions in question. Consent decrees and consent agreements are specific only to the companies that are parties to them.

VIII – Issues Not Addressed in Law

When drafting the new directive on Unfair Commercial Practices, officials of the European Commission considered limiting the number of levels that a company could consider when calculating bonuses in MLM compensation systems. The goal was to ensure that companies were not operating "endless-chain" schemes. With research, they found that MLM companies imposed their own limits on bonus calculations but that no two companies used identical systems.

Some limited the payments to four levels. Others – notably including Amway – allowed a distributor to "break away" when his business reached a "stand-alone" level. This allows those who work hard to surpass their sponsors. It also allows the company to disregard inactive distributors in a line of sponsorship whose presence would otherwise distort bonus calculations.

EC Officials decided not to limit bonus payments by levels. As a consequence, neither the EU nor any other jurisdiction has specific rules regarding how to calculate bonuses. Rather, officials around the world allow companies to compete with one another in the structure of their compensation systems, a position that has worked well.

As the U.S. FTC noted, false earnings claims are the "enticement" that prompts individuals to invest in business opportunities where they do not earn as much as they would hope. Nonetheless, only Singapore has broad-based rules requiring disclosure of income earned by distributors for all MLM companies. Several countries require documentation of claims if they are made but do not require documentation of a claim if no claim is made.

We would also note that no government requires companies to report on their internal enforcement efforts. Yet, internal enforcement of rules is among the most critical factors in ensuring that a company operates in a manner consistent with a country's legal provisions and the ethical standards of the industry association.

IX – General Principles and Summary

The foregoing discussion of laws and regulations has highlighted general trends and regulatory approaches around the world. The rationale for these approaches to regulation can be summarized as addressing several issues that are known to have been associated with the direct selling industry.

1. Easy In, Easy Out – Because it is inexpensive and easy to enter into a direct selling business, it is important that leaving the business be easy as well. The main concern in this regard can be excess inventory. Most countries and the WFDSA Codes of Conduct require the supplier company to repurchase marketable inventory, assuming that it is in condition to be resold. The WFDSA Codes require member companies to repurchase unsold inventory subject to a small restocking and administrative fee if the returns are requested within one year of purchase. This also helps to eliminate inventory loading, which occurs when a supplier company refuses to repurchase unsold inventory.

2. No sales. No payments – Improper payments have been made in some cases to induce distributors to recruit others to join the system. Such payment systems are a clear sign of fraud as such a sales system cannot be sustained. To combat this type of fraud, almost all countries prohibit payments made for the purpose of recruiting new distributors and require that all commission and bonus payments must be based upon sales of products or services. As such, bonuses recognize the value of sales support and ancillary services. The formula for computing bonus payments varies as companies compete to develop attractive payment systems.

3. Attacking "Get Rich Quick" Claims – False claims of profit potential can induce individuals to enter a sales system by causing them to believe that they can earn money easily or earn unrealistic profits. A complete disclosure will tell prospective distributors how much he or she might earn. It should also make clear that, although an experienced and dedicated distributor might earn a reasonable sum, a new or part-time distributor will earn much less.

4. Company Rules Enhance Government Regulations – Abuse of new recruits by other distributors is possible when supplier companies allow distributors to solicit others to join the sales system. To prevent such abuse, the supplier company must commit to resolving economic differences among distributors once the company is notified of an issue. In resolving the issue, the company should have the power to compel an up-line distributor to make restitution to down-lines and withhold commission and bonuses from the up-line in order to make the restitution. Governments have found that when companies are asked to enforce their rules strictly, consumers are more fully protected. Doing this effectively, however, requires governments to inform companies of violations by rogue distributors who may be trying to hide their misdeeds from the company.