

Multi Level Marketing: An Emerging Industry Waiting for Policy Changes & Regulatory Support to Empower Millions in India

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Abstract

With the passage of time, new concepts and ideas emerge in every sphere of life and the field of marketing is no exception to it. Traditionally marketing was considered to be the work of professional, full time marketers but there is a new concept called “Multi Level Marketing” which is making marketing every body’s cup of tea. A person with strong determination, ability to work hard and good communication skills can jump into this system. As no system is free from defects so is MLM. It is often criticized by people on various grounds; often it is charged with similarity to pyramid schemes. All marketing educators need to be able to avoid unethical and/ or illegal business activities. However, as has been pointed out by Vander Nat and Keep (2002), some of these unethical/illegal marketing scams have many of the same characteristics as legitimate multilevel marketing organizations. Sometimes it is a challenge for regulators to deal with companies that operate in the gray area. Even if a company is fulfilling its legal obligations, that does not mean all its practices are ethically correct as legal does not necessarily mean ethical. The current paper discusses ethical and legal issues in multilevel marketing & the laws regulating this industry. The article begins with a brief overview of multilevel marketing, differentiates MLM from Pyramid schemes and some of the problems the industry faces. Finally the researcher provides some of the solutions for promoting this upcoming industry in India.

Keywords: Direct Selling, Multilevel Marketing, Pyramid Schemes, Unethical or Illegal, & Regulators

Introduction

In the past, little attention has been given to non store retailing such as direct selling, automatic vending, and direct mail. The "wheel of retailing" theory that explains the changes in retailing structure is not adequate to explain changes in non retailing structure. The secular trend theory is one alternative that explains changes in non retail structure. It states that adjustments in market offerings to satisfy more profitable, wealthier market segments cause movement along the wheel of retailing since these changes increase costs and prices. To explain non store evolution the secular trend theory can be expanded to one including macro environmental changes, including the development of an economy and the changing tastes and preferences of consumers.

Direct selling has no universally accepted definition. However, for the sake of convenience, it can be stated that, direct selling refers to selling of goods and services to consumers away from a fixed retail outlet, generally in their homes, workplace etc., through explanation and demonstration of the product by the direct sellers. Although direct selling has taken a refined shape in the contemporary era, it was known to Indians for more than 100 years. The old experience of the Indians procuring goods and services at their doorstep is

testimony to this fact. In such instances, the seller use to have; not only direct sales, but also establishes a personal relationship with his/her buyers. Inevitably and incidentally, due to this personal rapport, some other services, like investment advice, other useful market/product information etc., are given to the buyers.

Business organizations have long relied on direct marketing to target customers without spending a lot of money on retail distribution. However the Network (Multilevel) Marketers have taken the direct model one step further, i.e. not only they do the sales, but recruit and train new distributors i.e., independent sales persons who are members in the network marketing company. The big draw card in network marketing is the commission paid not only for direct sales made by the salesperson, but also from the sales made by the recruits made by him. That is, if you get friends and relatives to join up, you get a commission not only from the products your friends and relatives purchase, but also from the sales they make to their friends (Bloch, 1996).

Network Marketing is a subset of direct selling and is also known as “multilevel marketing”, “structure marketing” or “multilevel direct selling”. Network marketing can best be described as a direct selling channel that focuses heavily on its compensation plan because the distributors (members of the network) may receive compensation in two fundamental ways. First, sales people (distributor) may earn compensation from their personal sales of goods and services to the consumers (non-member of the network). Second, they may earn compensation from sales to or purchase from those persons whom they have personally sponsored or recruited into the network (down lines), these down lines continue sponsoring or recruiting to the network sharing the benefits with their sponsors or recruiters (up lines). Hence, the network marketing organization can be defined as “those organizations that depend heavily or exclusively on personal selling, and that reward sales agents for (a) buying products, (b) selling products, and (c) finding other agents to buy and sell products” Further, the distributors receive a net commission on the sales of those they recruit into the network. The sales developed from network marketing are not developed solely from sales created by retailing, but also developed through recruiting or sponsoring independent distributors. Thus MLM works on the concept of time leverage..

Direct selling market in India

The direct selling industry came into existence in India in early 1980’s. However it gained momentum in early 1990’s when the country liberalized its economy with the global players entering the Indian market. Amway was the first major global direct selling company to enter India in the year 1995, which was followed by companies like Tupperware, Avon and Oriflame. Around the same time Modicare was one of the first few Indian companies to adopt this channel of distribution. The direct selling today has taken gigantic proportions with a formal outlook wherein not only Indian but foreign partners have invested in to this sector. The total fiscal contribution of direct selling industry in India is Rs. 68,859 million during the financial year 2012-2013. The direct selling market in India has grown at a CAGR of 21% over the past five years. The market grew at a lower rate in 2012-13, but that was possibly due to a short global slowdown. In future, the industry is expected to witness robust growth with increasing product demand and penetration of direct selling.

The direct selling industry spans across a diverse range of products. However, specialized products requiring one to one interaction and demonstration with the customers such as health and wellness products, cosmetics and personal care products dominate the direct selling market. Health and Wellness is the largest direct selling segment capturing a market of INR 31.5 billion in 2012-13. Cosmetics & personal care generated revenue of INR 23.5 billion capturing a 35% share in the market. Marketing strategies of companies have increased consumer awareness about hygiene and cleanliness in urban and rural areas which

has led to increase in demand for Homecare and Home improvement products. With a market size of INR 7.4 billion, this category had an 11% share in the total direct selling revenue in 2012-13.

Ponzi/Pyramid schemes

The number of multilevel marketing organizations has been increasing, and the number of people involved is increasing exponentially. As more people become a part of the multilevel marketing business model, the negative impacts of some multilevel marketing organization practices on people's lives is growing due to the high potential for moral hazard amongst multilevel marketing organization leadership.

Pyramid schemes are an illegal form of multilevel marketing. They use much of the same organizational characteristics, including the up-line recruiting the down-line, but also include extreme moral hazard issues. Early pyramid schemes used only the promise of future returns to lure participants. Participants would realize returns by recruiting more into their down-line. As more people were added to the model, the likelihood of realizing a larger return increases with each level added. This means there's an incentive for a person in a particular level to recruit as much and as fast as possible without helping their down-line. This is especially true for modern pyramid schemes that include a product, rather than just returns. In this model, adding more people to the pyramid increases the likelihood of other people being unable to make money, but the up-line continues to recruit others because the negative effects do not impact them. Therefore, there is a moral hazard for the up-line, leaving the down-line unprotected.

Key Differentiators- Direct Selling and Ponzi/Pyramid schemes

S. no.	Parameter	Direct selling business	Ponzi/Pyramid scheme
Structural Differences			
1	Definition	The process of selling consumer product or service from one person to another, in an environment that is not a permanent retail location	Compensation is base on recruiting new participants, not on selling products Focus is on rigorous enrollment of new subscribers/investors with an aim to collect easy money from new subscribers
2	Objective	High sale of product	Offer no real business opportunities as these schemes generally do not involve products or involve products which are illusionary or have no established market value
3	Opportunities offered	Offers genuine business opportunities as they involve sustainable sales plan of goods No or reasonable entry fee usually for valuable support and starter products	
4	Cost of entry	Plans are primarily based on the value of sale of products and recognition of services for the sales support provided by other	Comparatively high Plans are primarily based on money paid by new recruits, and not on product sales
5	Plan/Schemes		

distributors

Functional Differences

6	Mandatory Enrollment	Enrolment of recruits is not compulsory for doing business as primary objective is sale of products	Enrollment of recruits is compulsory for doing business as commission is based on the fee from new recruits Either no products are involved, or else the products are a cover and are not really sold to consumers
7	Underlying product	Involves marketing of products under established brand names Highly competitive buy back guarantee to help ensure protection of distributor and end consumer	Products usually do not have a buy back policy or it is not followed in practice In case products are involved, "Frontloading" is encouraged and products are thrust upon direct sellers. Further, such products usually cannot be returned or resold to the seller.
8	Buy-back/guarantee of products	Products are supplied to meet genuine demand and direct sellers are encouraged to hold minimal inventory and replenish as and when need arises	There is no emphasis on product or product sales training
9	Inventory	Rigorous product and sales training is required	Usually, no refund or exit policy exists
10	Sales training	Direct sellers joining the business can exit the business by returning the unsold inventory to the direct selling company	
11	Exit option		

Returns and potential benefits

12	Return vis-à-vis associated risk	Returns are dependent on the time invested and motivation of the direct seller which are generated slowly. Thus, returns depend on the value of product sold, not on the number of recruits Sales incentive are primarily derived from sale of goods and are paid directly by direct selling companies through normal banking channels	Returns are directly linked to the number of persons recruited to join the scheme. Early entrants make very large returns. Late entrants cannot make any returns Incentives are based on recruitment of people rather than on sales. Payments are often made through members, and negligible pay outs by promoters
13	Sales incentive		

Legality of schemes

14	Registration/Licenses	These businesses are registered with local regulatory bodies in the country of existence or obtain licenses under a prevalent law Every salesperson has to abide by the industry Model Code of Ethics e.g. direct selling	These schemes are unregistered and not affiliated to any government body having power of legal enforcement
15	Adherence to code of ethics		Generally, no code of ethics exist at all

	associations, etc	
	These businesses have written rules and regulations and give a clear disclosure of the entire marketing strategy right from enrollment to receipt of remuneration/fees	These schemes usually do not have any written document imparting complete information and modalities of the scheme
16	Secretive and/or complex strategies	

Direct Selling – Regulatory environment in India

In order to manage the menace of pyramiding, many countries across the globe have either implemented new laws or made revisions to existing laws on direct selling in the last two decades. Both developed and developing economies have realized the potential of the direct selling industry in the light of positive socio-economic impact of this sector – both directly and indirectly. Many countries have given this sector an Industry Status.

The direct selling sector in India has a quasi-federal governance structure. The constitution of India has demarcated the areas of jurisdiction for the Central Government (Union List), State Government (State List) and joint administration for the Central Government (Concurrent List). According to the Indian constitution, wholesale and retail trade fall under the purview of state governments. Since direct selling is a part of non-store retail format, it falls under state legislation. However, this sector is also closely monitored by different ministries/departments of the central government.

Laws governing Consumer protection –

Ministry of Consumer Affairs, Food and Public Distribution

The Ministry of Consumer Affairs, Food and Public Distribution have two departments, namely the Department of Food and Public Distribution and the Department of Consumer Affairs, responsible for consumer welfare and regulation of internal trade. The main function of Department of Consumer Affairs (DCA) is to protect and promote welfare of consumers through the Consumer Protection Act, 1986. In carrying out its various functions, DCA is assisted by the Indian Institute of Legal Metrology. Another major thrust of DCA is to regulate internal trade within the country and it has undertaken many initiatives to ensure development of organized retail, single market for agricultural commodities, regulate retail infrastructure by way of allied laws, unified regime of consumption taxes, etc.

Under the Food Safety and Standards Act, 2006 (FSSA) regime, prior approval are required for every category of food (as defined under FSSA Act) or related products by a company before undertaking manufacturing and/or sales in any form. In an industry like direct selling, the major challenge under this statute is pre-registration of each and every distributor in the down line proposed to be engaged in direct selling of food products. Also the Competition Act, 2002, and its amendments regulate anti-competitive practices and are applicable to direct selling companies.

Administrative Laws

Ministry of Corporate Affairs (MCA)

MCA regulates corporate affairs in India through the Companies Act, 2013 (and the Companies Act, 1956) read with other allied Acts, Bills and Rules framed hereunder. The primary objective of MCA is to regulate corporate structure in India and ensure protection of investors and other business stakeholders. Any company, in contravention with the provisions of company law has stringent penal and prosecution consequences in India. Every direct selling business organized as Company in India adheres to the provisions prescribed under

the corporate law statutes essentially governing share capital of a company, functioning of the board of directors, furnishing of annual reports, necessary public disclosures, etc.

The Contract Law: The direct selling business is full of agreements between businesses and direct sellers. The roles and responsibilities of direct sellers are usually documented in a legally enforceable contract in accordance with the Indian Contracts Act, 1872.

In addition to the above, at the State Level, local and municipal bodies also have regulatory powers. The multiplicity of regulatory bodies at the center, state and local level has resulted in multiplicity of laws and regulations. The number of regulations and the extent of variations vary from state to state and their impact depends on the type of commodities traded.

Taxation Laws

Ministry of Finance (MoF)

The MoF regulates taxation (both corporate and consumption taxes) and custom duties on import/export in India. The taxable income of direct selling businesses is being regularly audited and scrutinized by the Indian revenue authorities. Moreover, direct sellers associated with these direct selling businesses are also contributing to the exchequer by depositing income tax.

Indirect tax levies:

The consumption taxes at the State level such as Value Added Tax (VAT) (on sales of goods) and Central Sales tax (on inter-state movement of goods) are also levied at every stage of sale of the product/goods.

Industry specific laws/guidelines

Misapplication of the Prize, Chits and Money Circulation Schemes (Banning Act), 1978 (PCMCS):

The Act was legislated in 1978 to regulate and ban fraudulent pyramid and Ponzi schemes prevailing in the country. Such predatory schemes manifest in various sectors including real estate, agriculture, on the internet and e-mail, and spread rapidly at times causing significant financial loss to the public at large. Although, nothing in this Act refers explicitly to direct selling businesses, still in certain states such activities have been alleged to be akin to money circulation schemes and thus, covered under the PCMCS Act. In this regard, it is relevant to note that PCMCS is an archaic legislation and was enacted around 40 years ago when Indian markets had not experienced any penetration by bona fide direct selling companies.

Guidelines at State level:

There are no specific regulations or guidelines governing direct selling activities in the Indian states except in Rajasthan and Kerala. The Nodal Industry Department of Rajasthan was set-up in 2012, with a view to regulate the sale of goods and services outside of retail establishments by way of direct selling and ensure protection of consumers, issued certain guidelines. These guidelines broadly define the contours of permissible activities which can be undertaken in the State.

In the absence of a sector specific legislation in majority of the Indian States, direct selling companies have been allegedly tagged along with fraudulent schemes under the PCMCS Act by the regulatory authorities of certain states. The state judiciary and regulators have alleged that some of the companies engaged in direct selling conduct 'money laundering activities' by promoting or conducting a scheme for making of quick and easy money. This

regulatory challenge has led to business uncertainty in India, with an added risk of harassment and business disruption.

Challenges due to current regulations

The current regulatory environment in India for direct selling companies is fraught with multiple challenges. Most of these challenges are common across direct selling companies, irrespective of the product categories they deal in. A big challenge is that the concept of direct selling and regulations relating to industry are not clear and operations of direct selling companies are often mistaken for fraudulent pyramid and ponzi schemes.

The Prize, Chits and Money Circulation Schemes (Banning Act), 1978

The Act was legislated to regulate & ban fraudulent pyramid & ponzi schemes prevailing in India. However, during the last few years, some Indian government authorities have, on a mistaken understanding of the direct selling model, have taken the view that direct selling companies are akin to pyramid based financial & money circulation schemes banned under the PCMCS Act.

The PCMCS Act, 1978, in its current form, is unable to distinguish direct selling companies from pyramid & ponzi schemes. Differences in interpretation regarding the applicability of the PCMCS Act lead to business uncertainty in India, with an added risk of harassment and business disruption. Direct selling companies have been facing problems in certain states like Andhra Pradesh, Kerala, etc. In these states, the direct selling companies have been charged with violating PCMCS provisions. Legal authorities of these states have incorrectly claimed that these companies are making money by recruiting people, and distributors are rewarded just for adding more people to the chain, with no genuine economic activity being carried out.

It is in this backdrop that the need to confer regulatory clarity and certainty to direct selling companies with legitimate businesses arises.

Definitional Issues

The lack of definitional clarity is another major issue impacting the growth of the direct selling industry. Contending that the absence of a universal definition of direct selling is a primary reason for confusion, it is being argued that a better understanding of the industry would require one to view it from three perspectives i.e. (1) Statistical; (2) Operational; and (3) Legislative.

Central vs State debate

No specific legislation for direct selling exists in India due to the Seventh Schedule of the Indian Constitution. Entry 33 in the Concurrent List talks about trade and commerce and specifically mentions “the products of any industry where the control of such industry by the Union is declared by Parliament by law to be expedient in the public interest, and imported goods of the same kind as such products.” However, subject to this, trade and commerce within the State is in State List. This has led to artificial compartments between FDI in wholesale and FDI in retail and FDI in multi-brand and FDI in single-brand. Such compartmentalization is likely impossible to enforce and is almost certain to be violated, deliberately, or inadvertently.

Possible solutions

To provide a conducive and sustainable operating environment in India for the companies operating in direct selling industry, a series of reforms are required ranging from immediate short term to long term measures.

Shot term reforms (0-6 months)

Amendment of the PCMCS Act:

Necessary amendments in the PCMCS Act are needed to make the distinction clear between direct selling & fraudulent pyramid money circulation schemes. The amendments may be based on the following principles:

- Activities for identification of fraudulent schemes:
 - Payment for recruitment: Where the scheme generates income based on recruiting alone, it is a pyramid scheme and thus, should be considered as prohibited activity.
 - Redistribution of joining or periodic renewal fees: Where there are entry or renewal fees that are redistributed to other participants in the scheme, it is a pyramid scheme and thus, should be considered as prohibited activity.
- Products are pushed on participants: Where participants, as a condition for joining or remaining in the scheme, are required to purchase a specified inventory of products which cannot, under normal circumstances, be resold or returned for a refund, a pyramid scheme may be presumed and should be considered as prohibited activity.
- Products are not refundable and returnable: Where customers and distributors are not offered a commercially reasonable opportunity in compliance with the mandatory provisions of local legislation to return product with which they are not satisfied, or which they are not able to sell, as the case may be, a pyramid scheme is presumed.
- Restriction on the commission paid to the distributor: The proportion of commissions on the sale of product that may be shared with distributors should be restricted to a reasonable percentage of the total revenue from sales to distributors.
- State government to have approval authority: It can be provided that only the schemes approved by respective state government would be considered as permissible activity.
- Mandatory to set-up 24*7 call center and pick center to address customer complaints.
- Compulsory accreditation of products: The products should be accredited from government approved quality institutes or adherence to certain pre-determined quality standards in India.

Medium term reforms (within 3 years)

Need to streamline Foreign Direct Investment (FDI) Policy

- Till now retail & direct selling companies have entered the Indian market through routes such as test marketing, sourcing from SMEs, franchising, wholesale cash and carry etc. As long as retail is treated as a sensitive sector, and there are multiple entry and operation routes, the sector may suffer from operational uncertainties.
- It is relevant to note that the operating structure of direct selling companies has close proximity to a wholesale cash and carry trade. Products are being sold by direct selling companies to distributors entailing sale to end customers. This model is substantially similar to a wholesale cash and carry trade.
- Under the extant FDI Policy, 100% FDI is permitted in wholesale cash and carry under automatic route, subject to certain prescribed conditions. Therefore, in order to end uncertainty, the Indian regulators should classify “direct selling” as a “wholesale cash and carry trade” with 100% FDI under the automatic route. In addition to the same, they may formulate additional stipulations governing direct selling players with well-defined KYC norms.

The FDI policy should be clear and transparent and should help ensure a stable operating environment. Otherwise India may not be able to attract the desired FDI and foreign companies in India will likely continue to face operational uncertainties. The foreign companies, who are presently in a ‘wait and watch’ mode, can also enter in case certain policy reforms are introduced in this regard.

Long term reforms (beyond 3 years)

Need for independent governing legislation

- At present, direct selling falls under the purview of state legislation and is also governed by a large number of ministries/departments at the centre, state & local levels. The multiplicity of regulatory bodies has resulted in multiple regulations and regulators governing this sector. These should be streamlined for the smooth performance and development of this promising sector and for setting up pan-India supply chain and manufacturing facility.
- Considering the above, the government should formulate a specific legislation governing 'Direct Selling Industry' with a precise and clear definition of 'direct selling activities' including legitimate MLM companies.
- Further, policies regarding registration of companies with a central authority, base on a clearly specified procedure and nominal registration fees, would help to distinguish between direct selling companies and companies running fraudulent pyramid schemes.
- "Trade and Commerce" being the State subject, from a consistency perspective, the power to define direct selling activities and demarcation of pyramid schemes from bonafide direct selling businesses may be provided at the Central Level. While the State government should be provided complete autonomy to implement the provisions of such Central legislation by way of formulation of inter-alia specific consumer protection Rules/guidelines governing the activities of direct sellers in each state.

Need for a Nodal Ministry

- There is no single nodal ministry at the centre at present and, hence, the grievances of this sector go unheard. Companies are not sure whether it is the DIPP or Ministry of Consumer Affairs, Food and Public Distribution that governs them.
- Therefore, a Nodal Ministry may be identified specially for the direct selling industry, which may act as a single point of contact.
- Given that the sector is predominantly based on consumer interactions, the Ministry of Consumer Affairs may be appointed as the Nodal Ministry for the direct selling industry.

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