DIRECT SELLING ASSOCIATION

Legitimate Direct Selling Companies Offer Many Consumer Protections

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The direct selling industry has been in the news recently as a result of inquiries by a prominent hedge fund manager. These inquiries have revived long-time interest in the difference between legitimate direct selling companies and illegal pyramid schemes. One very important difference is that legitimate direct sellers offer protections and guarantees to those that interact with them so their sellers and customers can be confident their interests are safe. Many of these are voluntary standards that exceed the requirements of any regulations created by the Federal Trade Commission (FTC) or mandated by federal or state law.

Members of the Direct Selling Association (DSA) have also pledged to abide by a strict Code of Ethics that outlines a high set of standards for interactions with both sellers and customers. Importantly, even many of these standards are not required by law, they are often used as benchmarks by law enforcement officials when evaluating the legitimacy of a company.

Here are some of the key consumer protections that legitimate direct selling companies offer:

- **Inventory Buyback**– While most direct selling companies do not require inventory purchases, DSA member companies pledge to repurchase inventory from any salesperson who decides to leave the business. Any inventory purchased in the year prior to the salesperson's departure will be repurchased for at least 90 percent of what was originally paid. Even the cost of the start-up kit is included in this requirement. Thus, the risk of "inventory loading"—being stuck with a garage full of inventory that no one can sell—and the potential for financial loss is eliminated.
- **No Large Up-Front Fees**– DSA members have also pledged not to charge unreasonable up-front fees for getting involved in the company. The cost of any start-up materials should provide the seller with the materials needed to get started selling such as product samples, catalogs, a training manual, etc.
- **No "Headhunting Fees"** – DSA members have pledged not to make payments for recruiting an individual a primary part of their compensation. Instead, sellers are compensated for the sale of real products to real users —not for recruitment.
- **No Outrageous, Unsubstantiated Earnings Claims**– DSA members pledge not to make claims that salespeople can make large amounts of money without time, commitment and effort, and any claims that are made have to be based on documented evidence and a real track record.

FTC Standards on Alleged Pyramid Schemes Based on Legitimate Operations

The distinguishing features of a pyramid scheme versus a legitimate company are really simple and straightforward. If compensation comes primarily from the payments made by those recruited into the business—it's illegal. If compensation comes primarily from sale of product to real users—including salespeople—it is legal. The FTC's job in a prosecution is to look at the facts and determine the source of the compensation.

There have been several notable cases involving alleged pyramid schemes that have helped shape the FTC's views in this area. Interestingly, the model for most of these standards came from the practices of companies the FTC ultimately determined to be legitimate operations. For example, in 1979 the FTC definitively decided that Amway was not a pyramid scheme based on several company policies including:

1. Requiring sellers to have sold at least 70 percent of the inventory bought during the previous month to qualify for compensation.
2. Requiring demonstration of sales to at least 10 different customers in a given month to qualify for compensation.

In the FTC's view, these requirements helped demonstrate that compensation was based on sales, not recruitment, and that no accumulation of inventory was taking place. Since that time, versions of what have been called the "70 Percent Rule" and the "10 Customer Rule" have been adopted as best practices by many direct selling companies. It is important to remember that these practices are merely benchmarks and are not requirements of the law, nor is their existence alone definitive proof that a company is not a pyramid scheme. However, existence of rules such as these provides strong evidence that a company is doing its best to eliminate even the possibility of pyramid-like abuses. Much confusion exists about the "70 Percent Rule" and the related issue of "internal consumption."

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In the case of Amway, these practices were already voluntarily in use by the company. Since that time, however, there have been cases when law enforcement has taken action against an alleged pyramid scheme, ultimately requiring the company in question to adopt versions of these industry protections in order to continue to operate as legitimate, reformed operations.

Popular culture may mock pyramid schemes, but the bottom line is that they do exist and it's important to know the facts about how to identify them – both for one's own protection and to avoid missing out on the great products, services and opportunities provided by legitimate companies. Millions of Americans and people around the world benefit from the income they make through direct selling and enjoy the products they purchase. Direct sellers are the original word-of-mouth marketers – using personal recommendations to connect people and products. In a time when social media makes word-of-mouth a preferred method of gathering information and making purchasing decisions, direct selling couldn't be more relevant.