

**THE MULTI-LEVEL MARKETING FIRMS:  
ORGANIZATION AND MARKETING STRATEGY**

by

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UNIVERSITY OF PARIS IX-DAUPHINE  
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in Partial Fulfillment of  
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## **ABSTRACT**

**This thesis first is concerned with multi-level marketing companies, also called network direct selling firms. We will discuss both their method of selling through party plan and their network characteristic, which is a method for recruiting independent distributors. We will analyze how these firms have been able to position themselves as an alternative distribution channel vis à vis retailing. We will then show how these firms have managed to take advantage of the recent trends in customer requirements in terms of the quality of service and information they expect in their day to day shopping. Finally we will touch on the boundaries that differentiate legal network direct selling organizations from illegal plans.**

**The thesis focuses on identifying and discussing the distinctive components of multi-level marketing firms' organization and marketing strategy that make them successful in the United States. We will understand that both the apparently flat meritocratic organization and the status of independent distributor which these firms propose correspond to the expectations of some people who are unhappy with the classical bureaucratic organizational form. We will study the critical aspect of their marketing strategy, which is the management of the firms relationship with its network of distributors, show that firms must propose an attractive and long term oriented remuneration plan in order to build a reliable and long lasting network of distributors. We will also see how successful multi-level marketing firms have been in using an ideology and a charismatic leader to expand their network.**

**Finally, an analysis of the experience of Amway, a multi-level marketing firm, in France and in Japan will allow us to understand that this concept is hard to export successfully. We will see that in France cultural differences have prevented Amway to apply the organizational and marketing tools it has developed in the United States in order to manage its network of distributors. Although in France multi-level marketing firms are not experiencing success, in Japan Amway is one of the most prosperous foreign firm involved in consumer goods. We will understand that the specifics of the Japanese consumer and market has made it easier for Amway to apply its way of doing business.**

**Thesis Supervisor: Professor Birger Wernerfelt  
Title: Professor of Marketing**

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**I am dedicating this thesis to:**

**Anouk, for her love and support and for all the miles she has accumulated during those two years**

**Gislène and André my parents, for 29 years of love, support and trust**

**Johanne my sister, for 23 years of love, care and teasing**

**Liliane and Joseph my grandparents, for many more years of happiness**

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**And finally to all my friends and family from MIT, France and Israel**

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## **INTRODUCTION**

In the early 1970's in Oklahoma "Prepaid Legal Services" (PLS), a private company was created. PLS business idea was to provide individual families with affordable legal services as well as some insurance, for a monthly fee of \$16<sup>1</sup>. By 1986, the company had reached a level of 500,000 subscribers and revenues of \$42 Million. The way PLS signed up members is original for a prepaid legal plan, and it has been borrowed from the consumer good market. Indeed, PLS uses a multi-level marketing (i.e. network) method, in which each of its sales associates or independent distributors are also subscribers. Each time the independent distributor signs-up a new subscriber, he receives a commission, and each time someone he has signed-up enrolls another person, he also receives overrides.

PLS has used one of the several direct selling techniques in order to nurture its growth.

The three main points of direct selling are summarized by B. Rosenbloom<sup>2</sup> as follows:

"(1) Direct Selling is a method of selling , or in other words, a particular type of marketing channel that goes directly to consumers' homes; consumers do not go to retail stores. (2) Direct selling is concerned with the sale of consumer products in consumer markets (...). (3) Unlike direct marketing (...), direct selling involves salesperson meeting face to face with customers either one on one with the customer or in party plan situations where the sales presentation is made to a group of people, invited to someone's home".

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<sup>1</sup>"Lawyers go mass market", A. Urbanski, Sales & Marketing Management, 1988 IAC

<sup>2</sup>"Marketing Channels, A Management View", Fourth Edition, page 480, Bert Rosenbloom, The Dryden Press, 1991

**This thesis will focus on multi-level marketing firms also called network direct selling organizations (network DSO). These companies sell mostly through party plan, as opposed to a one-to-one selling method. A party plan is a meeting at which several customers are gathered by a distributor in order to demonstrate and to sell them products. Multi-level marketing companies grow their sales force through a system of network of distributors. This mechanism of sponsorship, a form of recruitment, that has been described earlier with PLS, creates financial ties between distributors and generates an additional source of revenue for them. Finally multi-level marketing firm use the performance of their distributors to create a hierarchy which doesn't confer any authority power, since distributors are independent. The preeminent multi-level marketing firms are American, and their names are; Amway, Mary Kay Cosmetics, Shaklee etc.**

**The goal of this study is to first understand in Part 1 how network DSO operates in the United States, and what alternative do they propose vis à vis other distribution channel like retailing. Then we will understand the roots of the development of legal multi-level marketing organizations and where does the boundary stand in between legal and illegal plans. Then, in Part 2, on the basis of an analysis of the typical organizational structure and marketing plan of American multi-level marketing firms we will determine the key factors of their success. Finally, in Part 3, an overview of the network DSO in France and in Japan will allow us to check the validity of the arguments developed in Part 2.**

## **PART 1: THE MULTI-LEVEL MARKETING COMPANIES' APPROACH TO DIRECT SELLING**

### **I.1) Direct Selling, an effective selling approach**

#### **1) The Party Plan technique - strengths and weaknesses**

In 1993, this sales approach accounted for 21.4%<sup>3</sup> of sales dollar generated by the whole direct selling industry. Under this system, a sales representative, which is called a distributor, gather five or six persons, usually at one of these potential customers' home. The way those meetings are organized may differ slightly from one company to another, but they usually follow a thorough predetermined sequence of events that are designed to create an atmosphere that fosters sales. First, the distributor warms-up the atmosphere by organizing games of which winners will get gifts. Often refreshments will be served. Then products from the company are presented and demonstrations will take place. This friendly atmosphere enables the guests to exchange their views on the products and give advice, built on their personal experience, to others. Guests know that their host expect them to buy at least one product, and most of the time they will do so in order to please their friend. The first person who buys, trigger further sales by others since a kind of emulation effect takes place.

The reasons why multi-level marketing firms have preferred party plans to the one-to-one selling method are well summarized by the "1993 Multi-Level Marketing Executives Industry Survey Summary Report"<sup>4</sup>. One-to-one selling is for 26% of the executives surveyed "more personal and/or individualized", but at the same time 33% believe that as

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<sup>3</sup>"1993 Direct Selling Growth & Outlook Survey", DSA 1993's Fact Sheet.

<sup>4</sup>Anne Coughlan, Kent Grayson, Kellogg Graduate School of Management, Northwestern University, 1993



compared with groups, one-to-one selling "have less excitement/energy", and 12% believe that they "do not allow for third-party endorsement or testimony"<sup>5</sup>.

The most significant weakness of the party plan approach is that the level of coverage of the population of potential customers is low, since each distributor has a limited number of relatives and friends. At the same time, the distributor being independent, it is difficult for the company to control whether the market segments that are being targeted are the best suited for the products, or not. In addition, since it is not easy to get many people together because of schedule conflicts, repeat sales are more difficult to get with a party plan approach. Part 2 of the thesis will explain how some multi-level marketing firms have managed to deal with those problems by integrating direct marketing techniques to their strategy. We will just say that by helping its distributors with a direct mail campaign a firm will increase its chances of hitting the right customer segment, but at a high cost compared to the cost of running a basic direct selling business.

Finally, we will mention that the party plan approach has been extensively used by companies and that it is a victim of its own success. A party doesn't last a long time, and since companies know that their distributors will have time to present only a small share of their products, they tend to push them to organize other parties.

## 2) The network as a recruitment method: The network DSO

An additional feature has been added to the party plan approach and has given birth to the concept of multi-level marketing firms also called network DSO. As we saw it with the "Prepaid Legal Services" example in the Introduction, each independent distributor is going to develop a network of customers that will be allowed to become themselves

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<sup>5</sup>For more detailed, please consult "1993 Multi-Level Marketing Executives Industry Survey Summary Report", Anne Coughlan, Kent Grayson, Kellogg Graduate School of Management, Northwestern University

distributors. In order to motivate the original distributor to recruit new people and to build a strong and committed network, a financial incentive has been developed by direct selling firms, to compensate him for his time. This extra remuneration which takes the form of a kind of royalty is going to be explained in detail in next section.

## **I.2) Overview of the evolution of direct selling in the United States**

### **1) An alternative to retailing for certain products**

Bert Rosenbloom<sup>6</sup> quoting research from the Nowland Organization, analyzed recent market variables that have fostered the growth of direct selling over retailing; "The first finding is that increasing numbers of consumers, both male and female, have less time available for shopping in traditional retail stores (...). Second, customers are becoming more sophisticated in terms of demanding more and better product information (which are not anymore provided by traditional channels) (...). Finally, consumers are seeking increased convenience in all spheres of their lives, including shopping".

The products which are sold through direct selling have a social and emotional content. As we already mentioned (Exhibit 1) those goods are mainly cosmetics, home and family care products and health oriented. A view at the first steps of the Shaklee corporation, back in 1956, provides us with a nice example of the reasons why party plan selling was preferred to the retail distribution channel<sup>7</sup>. Shaklee's original products are food supplement based on a combination of various vitamins. In 1956 people were less health concerned than they are now and one of the biggest challenges that Shaklee's founders

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<sup>6</sup>"Marketing Channels, A Management View", Fourth Edition, page 485,486, 487, Bert Rosenbloom, The Dryden Press, 1991

<sup>7</sup>"The Shaklee Story", Robert L. Shook, Chapter 2, Harper & Row, Publishers, 1982

had to face, was to find the right distribution channel for those innovative products. They could have tried to distribute their products through the classical retail system, but they would have faced the risk that their goods would be lost among thousands others. They would also have had to budget a costly advertising campaign in order to educate customers. They didn't have the money for it and therefore they figured out that the most effective way of selling the product was through direct selling. In addition, Shaklee, as other multi-level marketing companies, bet on the old principles of direct selling; the word of mouth and the strong impact that sharing personal experience can have on sales, as well as the impact of personal demonstrations.

Direct selling is proved to be an effective way of bringing into market innovative products. The demonstration, under normal conditions of utilization, enables the salesperson to stress the benefits of the quality of a product that is not always noticeable by simply looking at the product. The Handbook of Modern Marketing R.L. Longwell mentions that "such commonly used items as refrigerators, vacuum cleaners, automobiles, home improvements, cook-ware, educational materials (especially encyclopedias), and greeting cards were pioneered and brought into general use by direct-to-consumer methods after most of them had failed to catch on through introduction in retail stores"<sup>8</sup>. Russel. Beach and Buskirk in their book "Selling, principles and practices". bring the idea that direct consumer selling is ideal for those products such as encyclopedias, for which the customer does not recognize a need; "they have to be sold directly to families because few people recognize a need for one and will go to a store to buy it. The need must be brought to the buyer's attention. Seldom will a retailer do such selling. Indeed, rarely will one encounter a retailer that does much creative selling"<sup>9</sup>.

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<sup>8</sup>"Handbook of Modern Marketing", Chapter 101, R.L. Longwell

<sup>9</sup>"Selling, Principles and Practices". Twelfth Edition, page 404. Frederic A. Russel, Frank H. Beach, Richard H. Buskirk. McGraw-Hill, 1988

## 2) The early days peddlers

The first idea that comes in mind when speaking about direct selling is that this form of distribution was extensively used during the old days, when the population was spread out all over the United States, and ways of travel and communications were not developed. This is true but we would like also to understand why, in 1994, direct selling and more precisely the multi-level marketing distribution channel is still an effective, profitable and popular way, to sell goods

From a historical perspective, the colonial peddlers were the first direct sellers in America. Although in the twentieth century the development of infrastructure and department stores had diminished the use and the number of direct salesmen, some manufacturers didn't want their products to be sold like numerous others' in those huge anonymous stores. Usually those manufacturers were producing products that were easier to sell through personalized demonstrations to the potential customer. In addition, one of the roles of the early peddlers who traveled from one city to another, was to convey information. They were bringing to the countryside information about what was happening in the cities, the new fashions, the latest technological innovations, the new social trends. At the same time they were providing the town manufacturers with the needs, requests and complaints from consumers. According to senior citizens it is amazing to see how the salesmen were expected and welcomed in remote areas at that time.

The modern multi-level marketing firms founders have realized both the social role of the early peddlers and how effective a modern version of this distribution system could be, in order to sell certain kinds of products.

### 3) The social trends that have supported the growth of direct selling

Historically, two trends in the American society, in the 1920's, had nurtured the growth of direct selling companies: the "scientific home making"<sup>10</sup> movement, and the women emancipation. The "scientific home making" movement, the ancestor of the smart house, was basically to bring home innovations that were developed in the industrial sector. Totally new home products were introduced in the market. They were considered easier to sell if they were directly explained to the customer and their effectiveness proven through private demonstration sessions. Those innovations were very popular among women who were more and more out of the house working. In the 1960's, many women were housewives and multi-level marketing organizations understood that women could be an easy manpower to target in order to promote their goods. Since the 1960's, direct selling companies have taken systematically and opportunistically advantage of the United States' social trends.

During the 1980's companies like Avon Cosmetics facing a slowdown in their sales, had followed women at their workplace, encouraging them to meet during their lunch hour. By 1988, 25% of Avon's US beauty sales were made at the work place<sup>11</sup>. In the 1990's multi-level marketing firms are trying to build their networks, by taking advantage of the part-time work trend.

Multi-level marketing firms have promoted work flexibility and entrepreneurship since distributors are totally independent and one's earnings are only related to the effectiveness of his or her work. In an increasingly segmented and anonymous society, these organizations are fostering contacts and direct relationships between distributors from diverse social and ethnic backgrounds. In a highly elitist and individualist society, those firms are claiming that distributors will succeed by collaborating with others instead of

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<sup>10</sup>"Charismatic Capitalism", page 26, Nicole Woolsey Biggart, The University of Chicago Press, 1989

<sup>11</sup>"Avon's corporate makeover", Working Women Ventures, February 1988

blindly competing with each others. Finally multi-level marketing firms try to demonstrate that any one can start successfully an independent activity and make a lot of money, without investing a lot when starting-up.

**I.3) Direct selling Growth and Outlook survey<sup>12</sup>**

In 1991, at the time when the United States Gross Domestic Product (GDP) was hardly reaching 2.5% annual increase, the direct selling industry was growing at 9.6% in terms of sales (6.6% growth after inflation). The Exhibits in this section represent the 1992 industry figures gathered by the Direct Selling Association (DSA), a Washington DC. trade group that represents nearly 100 companies that manufacture and sell goods and services sold directly to customers. The total 1992 retail sales were \$14.1 Billion. The total number of direct sales people was 5.5 Million in 1992, 90% of whom were female. From this population, 99.5% were independent contractors vs. employees, and for 89% of them, direct selling was a part time activity. Party plan selling which is the focus of this thesis, represented \$3.02 Billion of sales in 1992.

According to 1992's data, gathered by the Worldwide Federation of Direct Selling Associations, direct selling retail sales were at \$1.04 billion in France and at \$34 billion in Japan.

**Exhibit 1: Percentage of Sales by Major Product Groups**

Personal care products (cosmetics, jewelry, skin care, etc.)	36.4%
Home/family care products (cleaning products, cookware, etc.)	41.9%
Leisure/educational products (books, encyclopedia, toys, etc.)	13.4%
Service/miscellaneous/other	8.3%

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<sup>12</sup>This section is mainly based on "1993 Direct Selling Growth & Outlook Survey", DSA 1993's Fact Sheet

**Exhibit 2: Locus of sales (reported as a percentage of sales dollars)**

In the home	78.2%
In the workplace	10.2%
Over the phone	3.5%
At a public event (fair, shopping mall etc.)	3.9%
Other locations	4.2%

**Exhibit 3: Sales Approach (reported as a percentage of sales dollars)**

Individual, one to one selling	58.9%
Group sales/party plan selling	21.4%
Customer placing order directly with firms	19.7%

**Exhibit 4: Total retail sales**

	1987	1988	1989	1990	1991	1992
Total Retail Sales (\$Bn)	8.79	9.70	10.73	11.82	12.96	14.1
Annual Growth		10.3%	10.6%	10.2%	9.6%	8.8%
Consumer Price Index-CPI		4.1%	4.8%	5.4%	4.2%	3%
Growth net of CPI		6.2%	5.8%	4.8%	5.4%	5.8%

**Exhibit 5: Total number of sales people since 1987**

	1987	1988	1989	1990	1991	1992
Total Salespersons (M)	3.6	4.0	4.4	4.7	5.1	5.5
Annual Growth		11.1%	10%	6.8%	8.5%	7.8%

#### **I.4) The network of distributors and the mechanism of remuneration**

The system which has been set up by Amway France since 1977 is similar to any other multi-level marketing plan that is run anywhere else in the world. I will expose Amway France's scheme since it has been presented in detail to me by Mr. Clément, who is the permanent Sales Coordinator at Amway France<sup>13</sup>.

The commission that an independent distributor gets is based not only on his own purchases, but also on the business generated by the people he recruits. When a distributor buys items, it is usually to sell them to other persons (except when it is for his own consumption), thus sales are in general equal to purchases. At its level, the firm doesn't know what the distributor does with the products he buys since he is independent. Therefore, the multi-level marketing firm considers only the distributor purchases as the basis of the commission calculation.

Commissions must be set high enough to motivate the sales force.

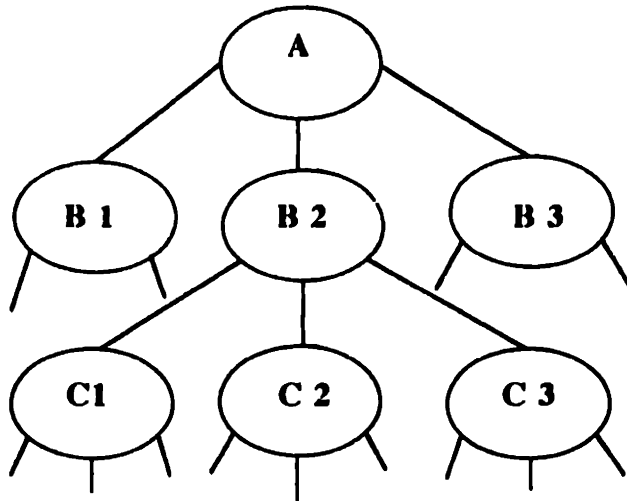
A network of distributors looks as shown in Exhibit 6. Each oval represents a person whose name is indicated inside it. A is the direct distributor, and is considered to be the "godfather" of the network. The B's and C's that A has sponsored or recruited, are his "down lines". The "tree" is often called "family" or "sisterhood", depending on the company.

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<sup>13</sup>Meeting with Mr. Clément at Amway France headquarters, Anthony France, 12/22/93



**Exhibit 6:**



There are three components to the retribution a distributor gets:

- the margin he takes on the sale of products (Selling price - Purchase price). Across the industry this margin is set in between around 30% of the purchase price.
- the classic commission which is based on how much he purchases a month.
- another commission: "commission d' animation", which stands for what he will get from the business generated by his network.

At each level of the French franc<sup>14</sup> (Frf) value purchase, a certain percentage is applied in order to calculate the amount of commission, as it is shown in Exhibit 7.

**Exhibit 7:**

Purchase (Frf)	1,110	3,885	7,770	16,650	27,750	44,000	66,600
Commission	3%	6%	9%	12%	15%	18%	21%

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<sup>14</sup> As a reference \$1 = 6 Frf

Let assume that A buys for 27,750 Frf worth of items. He will receive a commission of:  
 $15\% \times 27,750 = 4,162$  Frf.

Now assume that B1, B2 and B3 buy respectively for 3,885 Frf, 7,770 Frf, and 1,110 Frf.

Their respective commission will be:

For B1  $6\% \times 3,885 = 233$  Frf

For B2  $9\% \times 7,770 = 699$  Frf

For B3  $3\% \times 1,110 = 33$  Frf

As a "family", A & B's has accumulated 40,515 Frf worth of purchases. According to Exhibit 6, the family as a whole should get a commission of 15%:

Network's Commission:  $15\% \times 40,515 = 6,077$  Frf

Commission already distributed:  $4,162 + 233 + 699 + 33 = 5,127$  Frf

The difference which remains to be distributed, 950 Frf, will be given to distributor A as a "commission d'animation". Finally A will have received 5,112 Frf or 18.42% of its original amount purchased as commissions. A is not remunerated directly for bringing in new persons per say. This makes Amway multi-level marketing scheme legal.

This system repeats itself all along the network, for C's etc.. Some networks can contain several thousand people.

Certain distributors are not eligible for the "commission d'animation". They are called partners. The agreement a partner signs with the company differs from the one of a direct distributor in the way that it is not part of his mission to develop a network.

## **I.5) Multi-level marketing methods vs. pyramid schemes**

### **1) Pyramid scheme: an old trick**

In December 1919, in the US, years before the first network DSO was created, Charles Ponzi started his famous financial network. "Ponzi claimed he could make a profit by buying and selling international postal reply coupons in different countries because of the substantial rate differences after World War I (...) Ponzi offered to let others share in his investment strategy. He sold notes payable to investors promising return of principal and 50% interest in ninety days. In fact he returned the money as agreed to early investors within as little as forty-five days, building up confidence in his scheme. But Ponzi never bought the coupons, merely used the money of later investors to pay off early ones (...). Between December 1919 and August 1920, when a bankruptcy petition was filed against him, Ponzi received more than \$9 million"<sup>15</sup>.

Most of the people have once received in their mail a letter promising them a fortune in the future, in return for a small cash investment now to be paid to an unknown person at the top of a pyramid. Those schemes which are very similar to Ponzi's are called chain letters. Each participant pays for the chance to advance to the top of the pyramid and profit from payments of others who might join later. In one of its information brochure, the DSA warns the public against being fooled by pyramid schemes that look like legitimate business opportunities. Indeed, the pyramid may collapse long before the investor reaches the top, and the initial investment or more precisely the bet, will be lost for ever. It is easy to understand that the only way for every participant to win big would

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<sup>15</sup> "Charismatic Capitalism", page 45-46, Nicole Woolsey Biggart, The University of Chicago Press, 1989.

be a never-ending supply of new participants. In reality the supply of participants is limited and each new level of participants has less chance of recruiting others and a greater chance of losing money. Pyramid schemes are illegal and the participants are subject to legal pursuit.

Chain letters generally involve only cash and look easily suspicious, but many pyramid schemes' promoters try to hide their illegal business behind multi-level marketing methods, by selling consumer products to their recruits.

## 2) The lack of regulation makes it easy to run illegal schemes

In the US, there is not a unified set of laws regulating the multi-level marketing schemes. Instead there is a different law in every state or city. Since no central theory of regulation nor one comprehensive summary of the various theories exist, it is very difficult for a small business investor to evaluate a multi-level marketing plan. Nevertheless, federal agencies such as the FTC, the Food and Drug Administration (FDA), and the Security Exchange Commission (SEC) served as watchdogs to prevent any fraudulent schemes to grow. In 1979 the FTC held hearings on whether Amway's network, a DSA member, constituted a pyramid. The network character of the financial relationship, that was described earlier, according to the FTC's determination in the 1979 investigation of Amway, is not illegal. According to the FTC illegal schemes feature payments for which no product or service of value is anticipated. We understand that the essential element of a multi-level marketing system should be to sale products whereas illegal pyramid schemes focus on intensive programs to recruit new members for a commission.

Often state courts approach pyramid schemes as lotteries. By definition, a lottery is any scheme where one pays something of value to another in order to receive a return, based upon some formula of chance. With pyramid schemes, the element of chance is present because the financial gain is not within the control of the participant.

The lack of regulations enable some companies to set up illegal or close to the legal boundary businesses, and operate them for years without being really investigated. The story of Herbalife, a successful but often criticized company who started its operations in 1980, is a good illustration. Herbalife sells tablets and liquids that are supposed to help people lose weight and feel better. The company has not been only questioned by the FDA because of the nature of its miraculous products, but also in 1985 it has been prosecuted for running an illegal pyramid scheme. Those events have not prevented the company from announcing 1992 sales of \$405 million and profits of \$20 million. The firm is still in business and has introduced a new marketing program, called Wealth Building, in 1992. This program in which recruits bought more to jump up the pyramid was, according to Forbes<sup>16</sup>, "run by Lawrence Thompson and Larry Stephen Huff (...). Huff was one of the people behind Holiday Magic Inc., a multi-level direct sales cosmetic marketer (...). In 1973 the SEC charged it with defrauding its distributors of \$250 million.(...) In 1987 Huff pleaded guilty to conspiracy to commit mail fraud in connection with an illegal Ponzi scheme called Culture Farms (...) He was sentenced to two years in federal prison". Those two persons are not working for Herbalife anymore, but it is amazing and scary to see how easy it is to come and go in this business and make big money by using controversial methods.

The legitimate network DSO companies are suffering from a bad image conveyed by those highly publicized stories. The DSA as well as the MLMIA, the two trade agencies covering multi-level marketing methods, are making a lot of public relation efforts in order to prevent any naive person to be ripped off by illegal scheme, and to improve the multi-level marketing image. They investigate every suspicious activity they are aware of, and don't hesitate to take action.

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<sup>16</sup>"Betcherlife Herbalife", Dana Wechsler Linden and William Stern, Forbes March 15 1993.

The DSA's mission, as it is stated in its brochure, is "To protect , serve and promote the effectiveness of member companies and the independent business people it represents. To ensure that the marketing by member companies of products and/or the direct sales opportunity is conducted with the highest level of business ethics and service to consumers". The Association's Code of Ethics lists guidelines for companies and salespeople to follow in selling products, recruiting new sales people and working with sales people. Each DSA member company must pledge annually to follow the Code, and companies applying for membership assume a one year probationary standing while their business practices are investigated by the DSA's staff.

### 3) The key elements of differentiation

There are a lot of articles written in the popular and specialized press in order to inform the public about the easiest ways to detect a suspicious scheme. The elements of differentiation that are most commonly often mentioned are the following<sup>17</sup>:

- sales methods must be based on skills or expertise.
- participants, as independent distributors, must maintain managerial control over the essential conduct of their enterprise, and no compensation of any kind may be earned from only bringing in others into the system.
- resale price maintenance agreements at either the wholesale or retail level, or any action to enforce suggested prices or to prevent advertising of retail price is prohibited. Indeed certain aspects of pyramid schemes can violate antitrust regulations. "Not only are explicit pricing element illegal per se, but implicit agreements or "rules of conduct" with

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<sup>17</sup>"Direct marketing's other side: official praises industry, warns against pyramid sales", interview of Doris Wood, President of the MLMIA, Los Angeles Times, August 20 1990.

a direct and substantial affect on retail prices are also in violation"<sup>18</sup>.

- no initiation fees, charges memberships, or large initial inventories may be required to become or remain a qualified distributor.
- to discourage inventory loading and encourage retailing to ultimate consumers. "Buy-Back", "70%", and "10 customers" rules are necessary. The "70%" rule requires that a distributor must sale as retail or wholesale 70% of his or her monthly purchase to receive a performance bonus. The "10 customers rule requires that a sponsoring distributor make at least one sale to at least 10 different customers each month, which should insure that retailing is an essential duty of the distributor."<sup>19</sup>
- Advertising of specific dollar representations of sales, profit, or earnings must include the category's average or the percentage of individuals who achieved the indicated level of success.

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<sup>18</sup>Multilevel franchise or pyramid scheme", *Journal of Small Business Management*, October 1985.

<sup>19</sup>"Multilevel franchise or pyramid scheme", *Journal of Small Business Management*, October 1985.

## **PART 2: THE DISTINCTIVE COMPONENTS OF THE NETWORK DSO'S MARKETING STRATEGY**

The two most critical challenges a multi-level marketing firm has to face are to lower the level of turnover of its distributors, as well as to be able to control a sales force made only of independent distributors. In order to respond to these challenges, companies have proposed a different kind of organization that uses a unique set of tools in order to manage and motivate the sales force. Multi-level marketing companies have also designed remuneration plans that looked attractive but which in fact, as we will see through the "1993 Multi-Level Marketing Executives Industry Survey Summary Report"<sup>20</sup>, don't reward the distributor fairly for the amount of work and time he usually puts in.

### **II.1) Network DSO as an alternative to the classical bureaucratic organizations**

#### **1) The common organizational structure**

Multi-level marketing companies have built their organization around independent distributors. As independent contractors, distributors are not eligible for company's paid benefits or vacation. The idea is that a start-up company with limited budget and innovative products will sell more by relying on independent sales people that can easily be motivated around three main ideas: the philosophy of free enterprise, the search for wealth and self motivation and personal development. As a director of sales development

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<sup>20</sup>Anne Coughlan, Kent Grayson, Kellogg Graduate School of Management, Northwestern University, 1993



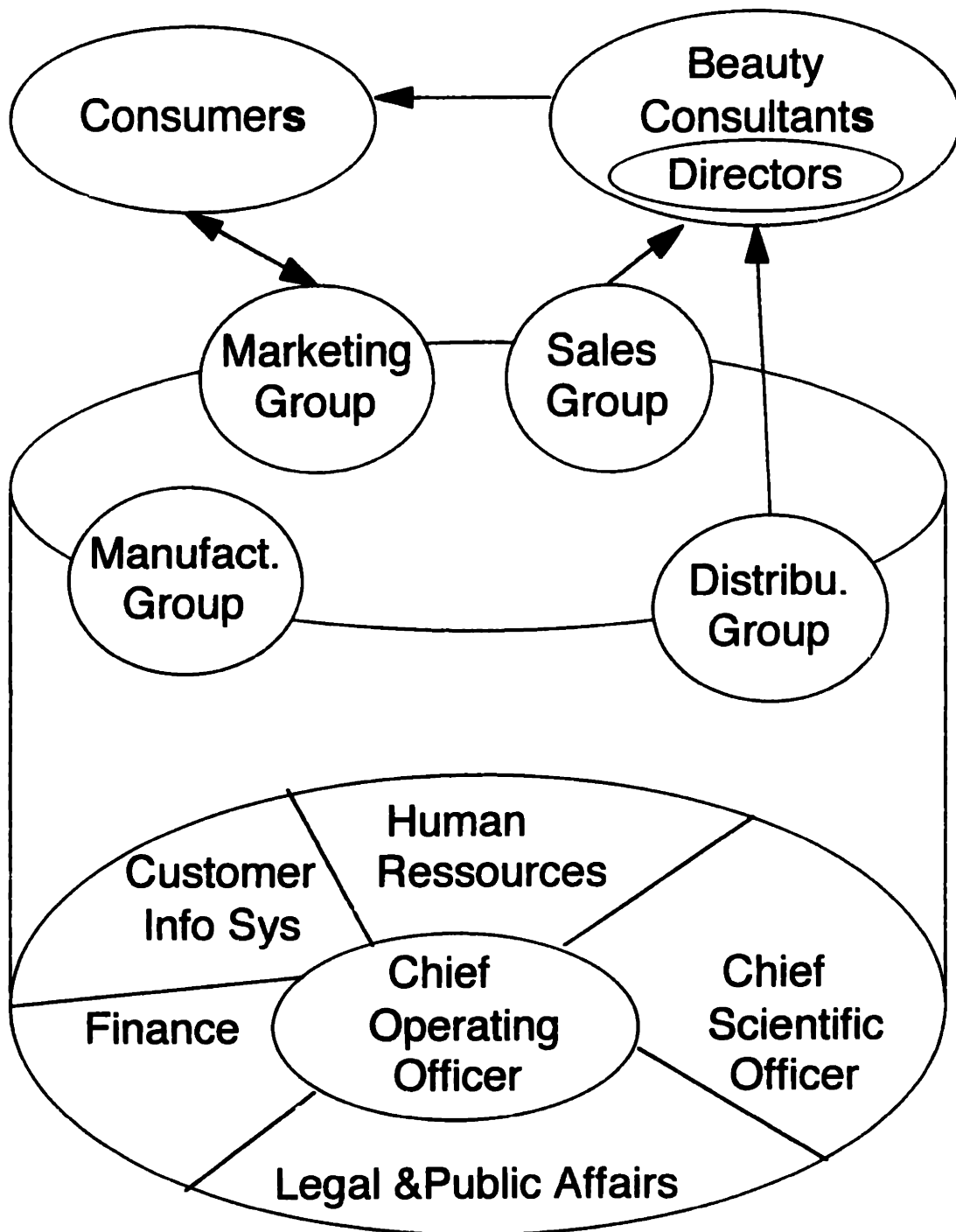
at Mary Kay Cosmetics put it<sup>21</sup> , "there are five things that all consultants seek. We refer to them as S-T-O-R-M: Satisfaction with a task well done (self worth); Team work (a sense of belonging); Opportunity (to succeed); Recognition; and Money. These five needs are being met through various aspects of our business".

Exhibit 8 features Mary Kay organizational structure, which is similar to most other network DSO. As we can observe, the main interface between the company and the market is the "beauty consultants". This was especially true when multi-level marketing firms were started. Since then, their organizational structure has evolved and they have to integrate marketing teams. The role of those teams has become very important in order to understand better the needs of more demanding customers. In addition, they have to work very hard at finding ways to retrieve the critical market information that is conveyed by their distributors.

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<sup>21</sup>"Mary Kay Cosmetics: Sales Force Incentives (A), Harvard Business School Case, 9-190-103, 04/07/92

**Exhibit 8: Mary Kay Organizational Structure<sup>22</sup>**



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<sup>22</sup>"Mary Kay Cosmetics: Sales Force Incentives (A), Harvard Business School Case, 9-190-103, 04/07/92

## 2) Innovative social relations and managerial strategies

In order to recruit distributors, the modern network DSO have marketed themselves as organizations where chances of success are equal for everybody joining the company, whatever his ethnic or professional background is. They have differentiated themselves from classical organizations by promoting a free enterprise concept where rewards are unlimited and are only dependent on the performance of the distributor. The performance of each distributor will depend on the effort he will put in his activity, but this effort being decided only by himself. The distributor, as the owner of his business, is not legally but only morally committed to the network. Network DSO look appealing to people that feel frustrated with their job because they believe they don't get the promotion or the salary they deserve since they are victims of the arbitrary of a boss or a bureaucratic non caring organization. Network DSO like to tell to their distributors, or write in their magazines, fairy tales of ordinary people whose fate has changed from the day they entered the network. For example, "The Shaklee Story"<sup>23</sup> describes the life of Carolyn Craft Spargur, an underpaid secretary with no hope who quit her job and quickly managed to earn more than her former boss and become the happiest person on earth, selling and consuming Shaklee's vitamins. Mary Kay is also portrayed as a poor working woman that had been able to make it thanks to direct selling and that has devoted her company to the development of women's leadership potential.

A Wall Street Journal report mentioned that " today women fill nearly a third of all management positions (up from 19% in 1972), but most are stuck in jobs with little authority and relatively low pay. Even those few women who rose steadily through the ranks eventually crashed into an invisible barrier"<sup>24</sup>. Multi-level marketing firms offer an

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<sup>23</sup>"The Shaklee Story", chapter 6, Robert L. Shook, Harper & Row, 1982

<sup>24</sup>"The Glass Ceiling". Hymowitz & Schellhardt, Wall Street Journal, 25 March 1986

**alternative for women segregation at the workplace, as well as for women whose job status has deteriorated over the years (nurses, teachers...).**

**Multi-level marketing understood early on the frustrations created by the classical American organizations and the alternative they have been proposing to potential distributors is directly drawn from the American tradition: a land of opportunity for everybody. As an example Amway stands for American Way.**

**Another major difference between a classical bureaucratic organization and a network DSO, is that the latter foster the involvement of the whole family in the selling activity of the one member of the family who belongs to the network. As opposed to other organizations where the private life must be left outside the workplace, multi-level marketing firms promote a global involvement of the family through many programs and activities. In addition, as opposed to the "non caring organizations", network DSO make every distributor feel he is important by providing him with a very motivating reward program.**

**Exhibit 9 summarizes the main differences between bureaucratic and network direct selling organizations, and makes us better understand the sociological reasons that have made the multi-level marketing companies a popular alternative.**

**Exhibit 9: Bureaucratic and Direct Selling Types of Organization<sup>25</sup>:**

	<b>Bureaucratic Organization</b>	<b>Direct Selling Organization</b>
<b>Legitimation</b>	<b>Universal rules, laws</b>	<b>Mission: substantive philosophy of founder and belief in moral value of entrepreneurialism</b>
<b>Membership</b>	<b>Bureaucratic officials</b>	<b>Followers</b>
<b>Differentiation</b>	<b>Horizontal differentiation by function; vertical differentiation by expertise</b>	<b>Minimal differentiation of sales work; administration separated and may be differentiated by function</b>
<b>Stratification</b>	<b>Hierarchical distribution of authority, reward and status</b>	<b>Undifferentiated authority structure joined to status hierarchy; administration may be hierarchical</b>
<b>Recruitment</b>	<b>Universalist appointment based on expertise and experience</b>	<b>Particularist recruitment for commitment potential, affective bonds</b>
<b>Compensation</b>	<b>Financial rewards, especially salary</b>	<b>Combination of material, purposive, and solidarity incentives</b>
<b>Character of Tenure</b>	<b>Career</b>	<b>Way of life</b>

<sup>25</sup>"Charismatic Capitalism", page 131, Nicole Woolsey Biggart, The University of Chicago Press, 1989

### **3) A different type of hierarchical structure**

Even though they seem to be a fancy alternative to hierarchical bureaucratic firms, multi-level marketing firms face problems:

- The turnover of their independent sales force is very high, generally above 100% a year. Harvard Business School case "Mary Kay Cosmetics Inc., Marketing Communications"<sup>26</sup>, gives an estimate of the company's turnover at 80%, compared to Avon's turnover which was estimated at 150% and Tupperware's at 100%, for the early 80's.
- The average amount of commission earned by a distributor is very often less than \$500 a year.

In order to make their independent distributors work harder, and to make them stay active for a longer time, network DSO have developed very imaginative hierarchical structure within their sales force. Distributors are classified according to their personal achievements, and also according to those of their downlines. At Amway, the different levels of achievements are named after precious jewels. They are called pin levels, since the distributor will wear a pin that symbolizes his achievement. In addition to the "classical" remuneration plan, each pin level features a new type of monetary or non monetary (trips, gifts, membership to exclusive clubs..) income. Distributors get their name and picture printed in the company's magazine and the size of the picture varies according to the level reached in the hierarchy. The hierarchical structure seems to be highly respected at least at Amway. In "Amway the cult of free enterprise" it is mentioned that when the company organizes a ceremony, the parking spots that are closer to the convention center are reserved for the best distributors, so that the others can see by

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<sup>26</sup>"Mary Kay Cosmetics Inc., Marketing Communications", Harvard Business School Case 9-5R3-068,

walking by that Amway rewards success by granting privileges. At company dinners, "ordinary distributors are not allowed to eat with the directs (distributors)"<sup>27</sup>.

Finally we can say that distributors are experiencing a paradox: they are first attracted by multi-level marketing firms since they expect to be free to succeed and independent, then if they are not provided with a set of hierarchical rewards from the company, they will lose their interest and motivation and quit.

## **II.2) The use of psychological managerial tools to sustain sales and to control distributors**

In complement to the hierarchical structure, discussed above, most network DSO firms have fostered an in-house philosophy carrying the supposedly right family values and displayed by a charismatic leader. Such a deep intrusion upon people's private lives, that is unique to the network DSO, is another way for the firm to limit turnover and encourage people to buy. It is also a technique used to keep control over distributors who are legally independent and who could jeopardize the image of the company by behaving unethically in the name of it.

### **1) The promotion of family values**

The goal of a company that set up a network of independent distributors which can recruit others, is to see their base of customers grow exponentially rapidly and at minimum cost. We understand that multi-level marketing firms benefit from fostering and exploiting family and friends relationship that one has. Network DSO offer a successful alternative to the classical organizations, by featuring the reunification of two spheres that are usually separated, work and family.

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<sup>27</sup>"Amway : the Cult of Free Enterprise", page 34, Stephen Butterfield, South End Press, 1985

The family concept is very important to network DSO, since one person will be more incline to share his experience of an outstanding product with close relatives. At the same time the close relative believes and trusts the experience of someone he likes, better that of someone he doesn't know.

For those economic reasons the main network DSO (Mary Kay Cosmetics, Amway, Shaklee...) have developed a philosophy that displays the ideal behavior towards family and friends. At Mary Kay Cosmetics, the philosophy is expressed through the Golden Rule, "Do unto others have you would have them unto you". Mary Kay Cosmetics, like all the other network DSO, provides training videotapes for the families. One of the videotapes, quoted by Fortune Mary Kay while addressing her distributors' husbands says, " I promise you your wife will be making three times the money of her corporate job. Plus, you' ll get the benefits of her living positively, putting God first, family second, and career third"<sup>28</sup>. If one has a look at Amway's monthly magazine AMAGRAM, where the pictures of successful distributors are displayed, he will be amazed to see more couples than the average population. "About 75% of Amway distributorships are husband-wife units. It is a major policy goal for the Company to involve both partners of a marriage in the business"<sup>29</sup>.

We see how the company philosophy is communicated to the members of the family that are not the official distributor since they could be able to support their partner by bringing in the network new friends and being positive. Positivism which is a characteristic that any salesperson must have, is overemphasized at some multi-level marketing organizations. At Amway people are taught not to be negative.

The intrusion upon the distributor's private life is aimed at creating loyalty in terms of consumption but also at controlling behavior in between distributors in the network, as a

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<sup>28</sup>"Mary Kay's lessons in Leadership", page 77, Alan Farnham, Fortune, September 20, 1993

<sup>29</sup>"Amway : the Cult of Free Enterprise", page 112, Stephen Butterfield, South End Press, 1985



lot of money is involved. Few people will try to take advantage of friends or family members by an unethical behavior. In addition, network DSO very often use a family image to call their network; at Mary Kay distributors belong to a sisterhood. When marketing plans are exposed to potential distributors, the companies make them understand that as opposed to any classical "bureaucratic" organization, their financial success is bind to others' performances in the network and that they will not benefit from retaining or hiding information from others.

## 2) The role of the charismatic leader

I was amazed when I visited the headquarters of Amway France in the industrial district of a Paris suburb, to see both the portrait of Amway founders Rich DeVos and Jay Van Andel exposed at the reception desk. It is obvious that some multi-level marketing companies have developed a cult of personality around their leaders that is interesting to mention. Myriad of biographies have been published on companies founders, many of them resembling Greek epics. We will not expand here on Max Weber, the well-known sociologist's, theory on "control strategies" and on his "model of charisma", to explain network DSO strategies in term of displaying a leader at big conventions, but the reader can refer to the analysis exposed by Nicole Woolsey Biggart, in her book "Charismatic Capitalism"<sup>30</sup>. In short she says that "DSOs do attempt to make distributors dependent socially, ideologically, and through their sponsorship lines, financially. DSOs' quite different strategies of control flow from their distinctive social relations of work and their basis in charisma"<sup>31</sup>.

Along with promoting the leader, it is a part of the strategy of some network DSO to exacerbate the religious feelings of their distributors. A Fortune magazine article on

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<sup>30</sup>"Charismatic Capitalism", chapter 6, Nicole Woolsey Biggart, The University of Chicago Press, 1989

<sup>31</sup>"Charismatic Capitalism", page 135, Nicole Woolsey Biggart, The University of Chicago Press, 1989

Mary Kay, mentions that "at seminar a sales director presented her with a drawing of Mary Kay and Christ, with Christ looking on approvingly"<sup>.32</sup>. We remember the company priorities: God first, family second, career third. Some companies, not all of them, but very often those who are selling food supplements (vitamins, diet products...), associate the ideology they carry with the product they sell. The distributor shares the steps he has made towards a better life by consuming the products he wants to sell.

### **3) Probable effect of the use of psychological managerial tools**

Early 1994, an American TV show<sup>.33</sup> specialized in sensational news has reported that Amway was acting at an economic level the same way as cults do on a religious level, by getting people together behind a common cause, surrounding them with social support and using a charismatic leader. Woolsey Biggart said in her 1988 book that Amway's "executives are modifying some of the original ideological zeal and repositioning the company as a powerful distribution network"<sup>.34</sup>. It is difficult to assess the possible impact of the use by some successful network DSO of an ideology as a marketing tool, since data in this matter are hard to collect. In addition this topic is highly controversial. A tentative to clear a little this debate can be drawn from Exhibit 10, which features the reasons given by the respondents to the "1993 Multi-Level Marketing Executives Industry Survey Summary Report"<sup>.35</sup> when they were asked to mention "the reason they first became a distributor."

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<sup>.32</sup>"Mary Kay's lessons in Leadership", page 76, Alan Farnham, Fortune, September 20, 1993

<sup>.33</sup>"American Journal", February 14 1994, NBC

<sup>.34</sup>"Charismatic Capitalism", page 145, Nicole Woolsey Biggart, The University of Chicago Press, 1989

<sup>.35</sup>"1993 Multi-Level Marketing Executives Industry Survey Summary Report", Anne Coughlan, Kent Grayson, Kellogg Graduate School of Management, Northwestern University

**Exhibit 10: "Most common reasons, categorized and sub-categorized"**

<b>Business/Financial Reasons</b>	<b>41%</b>
income opportunity	21%
challenge of building own business	7%
financial independence	5%
business opportunity	4%
develop new career	1%
<b>Product-Related Reasons</b>	<b>27%</b>
love/like products	19%
get product at wholesale	6%
share products with loved ones	1%
others want to get product through them	1%
<b>Personal/Social Reasons</b>	<b>16%</b>
associating with others	7%
more free time	3%
friend in the business	3%
enjoyed recognition	3%
<b>Company-Related Reasons</b>	<b>10%</b>
company track record/reputation	6%
training program/support	2%
mission	2%
<b>Plan-Related Reasons</b>	<b>6%</b>
marketing/compensation plan	5%
simplicity of plan	1%

The 1993 Survey warns that "it would be misleading to interpret such a wide array of reasons narrowly" but it is amazing that all the psychological tools that are used and that we described earlier in this section, are less important than we had imagined. Personal and social reasons account for only 16% of the reasons. On the contrary, it is clear that business and financial reasons (41%) are fueling the interest that people have in becoming independent distributors.

It is difficult to get a sincere answer to this kind of question, and generally people would tend to hide their ideological attraction to network DSO. Nevertheless it would be interesting to understand the reasons why people are becoming loyal customers and distributors, apart from product related reasons. In addition if the loyalty is so strong due to psychological reasons, it would be interesting to know if people are switching very often from one network DSO to another, or if they belong to two companies' networks at the same time. Part 3 of this Thesis concerns the successes and failures of multi-level marketing firms in Japan and France. We will analyze if psychological tools are used to manage the independent sales force and if they are, what is their probable impact on recruiting and sales.

Turnover of distributors is a problem that every direct-selling company has to face. John H. Whitney, Director of International Manufacturing at Avon Products, said at the MIT Sloan School of management<sup>36</sup> that they have been in the direct-selling business for more than 100 years but they still don't manage to reduce significantly their turnover of distributors. He mentioned classical "retention programs". Those classical incentives program are very close to the one proposed by network DSO. Avon doesn't carry any ideology and although comparative data on turnover are not available, their turnover rate doesn't seem to be higher than the one of multi-level marketing firms that do foster an ideology. Direct-selling companies and network DSO in particular are companies that are profit oriented and managed like any other firms. Even though an ethical behavior towards their distributors must be guaranteed, their overall marketing strategy shouldn't be limited to the point raised before. The next section focuses on the integration of direct marketing techniques in order to sustain network DSO growth in the 1990's.

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<sup>36</sup>Talk by John H. Whitney, Director International Manufacturing at Avon, MIT Sloan School of management, February 15, 1994

### **II.3) Integration of direct marketing techniques to network DSO strategy**

#### **1) An analysis of the distributor performance**

As we mentioned it, the sales force turnover rate is in average above 100% for most of the network DSO. In general, the 80/20 rules apply to direct selling. Indeed, usually 20% of a the distributors contribute to 80% of it sales. The remaining 80% of distributors sometimes give up after a few weeks. At MIT, John H. Whitney from Avon Products said that a more accurate and meaningful measure of turnover should consider the level of disaffection after 9 to 10 weeks, when the less motivated people would have already left . According to a study conducted by the DSA from 1980 to 1984, over a period of 5 years, 88% of all American households are contacted in direct selling and 63% make a purchase<sup>37</sup>. Approximately 75% of all US households are contacted by direct salespeople each year, and about half of them make at least one purchase. At Mary Kay, early 1980's repeat purchases accounted for approximately 35% of the company sales<sup>38</sup>.

This set of figures makes us realize that a lot of energy is wasted by companies and distributors. The range of coverage of the consumer market by multi-level marketing companies is extremely broad, and most of the firms must integrate direct marketing tools in order to spend their resources more effectively. An analysis of distributors' productivity, derived from Professor Coughlan and K. Grayson survey gives very interesting insights about the limits of the capabilities of an independent sales force. This survey has been implemented for the purpose of a global study, in order to develop "a

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<sup>37</sup>"A Statistical Study of the Direct Selling Industry in the United States, 1980-1984", Direct Selling Association, 1985

<sup>38</sup>"Mary Kay Cosmetics Inc., Marketing Communications", Harvard Business School Case 9-583-068, 1983

computer-based model designed to analyze how particular compensation plans affect the growth and productivity of MLM (multi-level marketing) networks".

Exhibit 9 and 10 summarize some findings of the "1993 Multi-Level Marketing Executives Industry Survey Summary Report"<sup>39</sup>. Exhibit 11 is directly taken from the study, and Exhibit 12 is derived from several different tables of the study.

**Exhibit 11: "Ways in which distributors spend their time in average"**

	Average Distributor	Above Avg Distrib	Top Distributor
Managing Network	37%	38%	52%
Retail Selling	35%	25%	12%
Recruitment	29%	36%	35%
Total hours/month	34	76	169

**Exhibit 12: Distributor's Productivity in average**

	Average Distributor	Above Avg Distrib	Top Distributor
# of hours needed to make one recruit	5.5	5.2	3.8
Value of products sold per hour	\$34	\$53	\$295
Income per hour	\$12.29	\$33.19	\$72.29

From Exhibit 11 we see that the difference between average distributors and above average distributors is a function of how they balance their time between recruiting and

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<sup>39</sup>Anne Coughlan, Kent Grayson, Kellogg Graduate School of Management, Northwestern University, 1993

selling. The difference between above average distributors and top distributors is a function of how they spend their time between selling and managing their network. From Exhibit 12 we see that top distributors are more efficient than the others at recruiting, but although they sell in average six times the value of above average distributors, their income per hour is only twice. Although above average distributors are equally efficient at recruiting than average distributors, their income per hour is approximately three times higher since they spend more time at recruiting.

The analysis of the data presented above, implies that network DSO through the design of their compensation system favor recruiting at the expense of selling. An average distributor that spends more time at recruiting will generate a higher amount of commissions, and will have more chances to become an above average distributor. While his network grows, he will have to spend more time managing it, since his network will be constituted of below average or just average distributors that have low motivation and which the probability that they will quit is very high. Finally the above average distributor might become a top distributor, but as we see from Exhibit 12 his effort will not be fairly compensated. The distributor is trapped in a negative feed back loop that gives him the best incentives to quit the network quickly. As we know from Exhibit 8 that 46% of the reasons that motivate distributors are financial, we understand that companies who are jeopardizing their own future because of badly designed compensation plan, are now revising their marketing plan.

Network DSO who used to not spend any money on training are starting to develop adequate training programs. First, the firm provides distributors with a better knowledge of their product. Second, since they have a better knowledge of their customer base through data base (please see 2)), firms are able to help their distributors focus on the right channel. The distributor will build a more reliable network, which increased efficiency will enable him to save a great and costly amount of time on its management

(Exhibit 12). In addition the level of disappointment will decrease at the distributor level, and the chances that he will quit the network will decrease too.

## **2) The challenge of building a customer data base**

Network DSO have realized that their competitive advantage over other firms which laid on the independent character of their sales force was fading. On the one hand the high turnover was responsible for this situation, and on the other hand some independent distributors were developing marketing tools on their own, that they would use in the name of the firm, and for unknown ends. Network DSO need to channel all those forces by developing and implementing corporate direct marketing programs to assist support and control their sales force.

In order to implement any efficient direct marketing technique, multi-level marketing firms have to build a data base of their actual customers. This is the most challenging job for network DSO. Indeed, most of the time they don't know who their customers are since the commercial relationship is managed by independent distributors who legally don't have to communicate any information to the firm. This independence status and the power that distributors believe it gives them account for globally 41% (Exhibit 10) of the reasons why they become distributors. It is difficult for them to accept giving information to the company without feeling that they lose their status. Mary Kay has designed in 1986 a direct support program. At the beginning, this program met distributors mistrust, but it was finally implemented in 1987. Blair Stephenson, director of strategic development at Mary Kay, was reported to say about the consultants that participate in the direct support program: "we have done the mailing for her. When the consultant enrolls her customers - she's the one who qualifies which customers she's going to enroll - we charge a fee of about 50 cents per customer. Once the customer is enrolled in subsequent enrollments, then we only charge 25 to 30 cents for the



re-enrollment of that customer"<sup>40</sup>). The distributor provides the customer's name, address and telephone. Mary Kay considers this mailing to be a service that it provides its distributors, since the distributor will receive a commission on the sale generated with the list of names he has submitted. The result for Mary Kay has been apparently very positive since "the average orders have more than doubled through the direct support program, and purchase frequency has increased. (...) Of the firm's 220,000 consultants, 40,000 to 50,000 are participating at any one time, and 125,000 active consultants have participated since it began"<sup>41</sup>.

By agreeing to give away information on their customers, distributors are in fact helping themselves since the company will implement direct marketing programs that will have the effect of strengthening and expanding their own network. Indeed the network of family, friends and relatives that anyone can build has a limit. Direct marketing helps pushing this limit forward.

When network DSO utilized their data base, they have to be very cautious in managing customers orders. Tupperware, when it started its program faced reliability problems in its distribution system. It seems that direct distributors can easily lose trust in the firm, if it doesn't prove to be reliable.

We mentioned earlier that multi-level marketing firms don't know their customers. Data base helps them to better know their average customer, his behavior, his preferences. Therefore companies can design better products, and a better strategy for spreading the efforts of its sales force. At Mary Kay, the company involves "its sales force in product policy decisions by sending them samples of potential new products and incorporating

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<sup>40</sup>"Glamorous Database", Pete Hoke, Direct Marketing magazine, July 1989

<sup>41</sup>Channel wars; Multichannel marketing", Direct Marketing Magazine, April 1992

their feedback in the development process. This involvement reduced resistance to product line changes and resulted in greater enthusiasm for new product introductions"<sup>42</sup>. Finally another way to get to know its customers better was experimented by Avon Products in the Philippines<sup>43</sup>. Since this country features many islands and its postal service wasn't reliable enough Avon dispatched distribution centers in key points, for the customers to get their products. Avon seems to have learnt a lot about its final customers in the Philippines, and is launching approximately 250 of those sales center in China, to support its entry in the Chinese market.

Finally, we will say that by building an accurate database in perfect harmony and trust with its distributor, network DSO are able to offer to their customers diverse ordering options (mail, fax, toll free number ...). These options help strengthen multi-level marketing firms competitive advantage versus consumers good manufacturers that use the classical channel of distribution.

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<sup>42</sup>"Mary Kay Cosmetics Inc.. Marketing Communications", Harvard Business School Case 9-583-068, 1983

<sup>43</sup>Talk from John H. Whitney, Director International Manufacturing at Avon, MIT Sloan School of management, February 15, 1994

## **PART 3: THE NETWORK DSO EXPERIENCES IN FRANCE AND IN JAPAN**

### **III.1) The network DSO in France<sup>44</sup>**

#### **1) An unfavorable legal environment**

The intricacies of the French legal system had prevented until 1986 multi-level marketing companies from developing a sustainable business. One of the reasons is that direct selling has a very bad image in France. For a long time the legal status of a part time independent distributor was not existent, and any potential distributor had to file at the national trade register as any other independent worker. This registration was costly since a fixed social security contribution was automatically due. For the first year of activity, the distributor had to pay to the national social security a minimum of Frf18,000<sup>45</sup>, and from the second year onward the minimum contribution due was Frf22,000. According to Mr. Dailey, director of the French DSA, Avon Products and Amway France started lobbying in the early 1980's in order for the legal system to be modified. In 1985, they obtained a commitment from the finance minister that no social security contribution will be asked to a distributor whose income will be lower or equal to Frf15,000. The French government has honored its commitment but it is not until 1993 that this question was settled by a new law that compel independent distributors to make a light contribution to social security. The French law regarding pyramid schemes is very clear, and it is not legal to pay commission for recruiting people in a network.

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<sup>44</sup>The facts gathered in this section come from: the phone interview that I had with Mr. Dailey, managing director of the "Syndicat de la Vente Directe" (French DSA) on 12/21/93, and my meeting with Mr. Clément, sales coordinator, at Amway France headquarters on 12/22/93

<sup>45</sup>\$1 = Frf6

## 2) Amway France: the search for the right strategy

Amway's French subsidiary was set up in 1977, and it started to grow consequently only since 1986, because of the legal constraints we mentioned earlier. Amway sales have been quite hectic, dropping from Frf323 M in 1985/1986 to Frf172 M in 1986/1987. By 1993 Amway's sales reached Frf60 M. In 1984 Amway France was a 210 employees company. It now employs 30 people. This gloomy picture is explained by the fact that the marketing techniques that we have described in Part 2 are either not in place nor efficient in France.

Amway France has built its French network of distributors by promising people big money without emphasizing enough the amount of work required. A large number of distributors who hardly understood the marketing plan was enrolled. Then they themselves recruited new people who obviously couldn't be informed properly. In the short run this strategy was profitable, and Amway had more than 140,000 distributors by August 1988. The company was expecting sales at \$500 M for the 1990's, when it sustained a downturn in its business.

At that time Amway was hit by a media campaign that targeted the ideology that the company conveys. Amway was criticized for the big "American type" of conventions that it was sponsoring in order to animate its network of distributors. The media was mainly concerned by the references to God that were reported to be made. Consumer trade association joined the press by questioning the integrity of Amway's distributors, and by comparing Amway's network to a pyramidal scheme.

Amway realized that its distributors were not loyal. Some distributors took advantage of their network by selling to others, products that were not from Amway. Others were promoting "indispensable" video tapes and publications if one wanted to make money. Amway who wanted to build a new image, reacted very strongly by canceling the agreement it had with most of its distributors. In 1988 the number of distributors had dropped to 25,000.

### 3) Cultural differences prevent network DSO to grow

The French experience of Amway is instructive. According to Mr. Dailey from the French DSA, multi-level marketing companies' distributors, are mainly motivated by the money they can get from this business and the autonomy they can achieve compared to a regular job. The alternative type of organization (Part 2 II) that Amway proposes seems to be its best competitive advantage in France.

Nevertheless, Amway seems to have fallen into the negative feed back loop described in Part 2 (II.3)). Indeed it has increased artificially the size of its network through short run incentives and miscommunication. Distributors don't have any incentive to stay long with the company and they deteriorate the credibility of the company, which makes it difficult to attract good people as customers as well as distributors. In addition, the French legal system through taxes seems to have limited the motivation that a distributor can have. Those factors prevent Amway from building a sustainable network with whom it can work, like Mary Kay did in the US, in order to build a customer data base. When I asked Mr. Clément about Amway's final customer, he told me that "they are the property of the distributors" and that there is no formal procedure of gathering information on them. Only word of mouth is used to understand customers, and Amway France marketing department consists of one person. Amway France provides a nice example to illustrate that a multi-level marketing firm must offer an attractive long term oriented remuneration plan, in order to attract good people. In addition in order to limit turnover, incentive programs as well as training must be put in place.

It would be too easy to blame Amway's management without trying to answer the question of whether or not any multi-level marketing firm can grow a sustainable business in France considering the particularities of the French culture. Amway was trapped in the worse scenario possible: the traditional means of controlling and independent sales force that helped the company be successful in the US were not working in France. The management of Amway seems to have realized that according to

the French culture and tradition of separation between government, business and religion, it is inappropriate for a company to raise family values or to refer to God in order to foster its growth. In addition, it reminds the French of the dark days of W.W.II when the motto of the pro-nazi Vichy government was: "Travail, Famille, Patrie"<sup>46</sup>. While I visited Amway Mr. Clément denied using any of those psychological tools to control and retain Amway's network. He said that Amway was working hard at communicating to its distributors that the whole network, including them, will be hurt if they behave unethically. Amway still believes in self discipline. Amway has also limited the use of its logo by its direct distributors and has included in the terms of their agreement that they are not allowed to sell any sales incentive tools without the company's approval. Because in France, multi-level marketing companies have not been able to find creative solutions to replace unsuitable psychological tools to manage their networks, they are not able to build on direct marketing techniques in order to enhance the growth of their business. This is rather pessimistic regarding the future of this distribution system in France, and contrasts with Mr. Clément optimistic forecast of a 25% annual growth in sales for his company. Mr. Dailey mentioned that multi-level marketing companies carry a very bad image in France, since many suspicious companies are created from one day to another. They build pyramidal schemes and then they disappear with the money of naive people. When I contacted one of Herbalife official distributor listed in the directory, in order to interview him, I experienced the fear and mistrust that other people have. This person was very nervous and suspicious about the fact that I wanted to interview him, and didn't want to see me. Mr. Dailey at the French DSA is working very hard at clearing the

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<sup>46</sup>It means "Work, Family, Nation"

image of the industry at the French as well as the European<sup>47</sup> level, but there is still a lot to do.

### **III.2) The network DSO in Japan**

#### **1) The Japanese consumer's expectations and direct selling**

It is highly difficult for foreign firms to penetrate the Japanese consumer goods market for both legal and cultural reasons. We will mention some of the main cultural reasons. The Japanese classical retail system is highly fragmented. In 1988 there were approximately 429,000 wholesale establishments in Japan, approximately the same number as in the United States, for a country of 122 million people and that has the same size as California<sup>48</sup>. The number of small stores is important and they represent the traditional way that Japanese enjoy shopping. Jun Matsunaga, a Japanese MIT student that I interviewed, told me that since the density of population is very high in Japan, people had traditionally developed network of neighbors, friends and family with whom they share products and which used to function as pyramid schemes. Although those typical pyramid schemes do not exist anymore since they are illegal, Jun Matsunaga mentioned that they are a good illustration in order to understand how personal relationships in trade are highly valued by the Japanese consumer. This supports the existence of a large number of "mom and pop" stores that can offer the same kind of personalized service.

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<sup>47</sup>A European charter of ethic in direct selling is supposed to be approved at a European level in Spring 1994

<sup>48</sup>"Marketers with a Yen; Entering the Japanese Customer market". Robert Garrity, Direct Marketing Magazine, November 1991

The Japanese consumer is "among the world's most demanding customer (...) Retailers, being very aware of the level of competition in their field, attempt to get even closer to their customers. Retail stores frequently organize fairs that highlight specific products"<sup>49</sup>. In summary, the consumer requires an extremely personalized service, top quality products, and he is mostly interested in "made in Japan" type of products. These characteristics have been integrated by direct-selling organizations that operate in Japan. In their article "Toward a Conceptual Model of Japanese Consumer Response to Direct Marketing", Wongtada & Zerio mention that "in persuading those groups (Japanese consumers) to patronize nonstore retailing, direct marketers will have to provide services comparable to those of Japanese stores that pamper consumers to an extent unknown in the Western world. Therefore, the crucial factor is not what the direct market offers to consumers, but how attractive such offers are perceived to be in comparison with those conventional stores"<sup>50</sup>.

Since the Japanese distribution channels are not pushing foreign products, direct selling is a good way for foreign firms to introduce their products, given that they would provide first class service and quality and that they would fulfill the taste of Japanese consumers. Network DSO, in particular, seem to fit to some of the Japanese customers' requirements.

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<sup>49</sup>"Japan's Market, The Distribution System", page 100, Michael R. Czinkota & Jon Woronoff, PRAGAER, 1986

<sup>50</sup>"The Japanese Distribution System", page 207, Michael R. Czinkota & Masauki Kotabe, Probus Publishing Company, 1993



## 2) Amway's success in Japan<sup>51</sup>

Amway's strategy in Japan has been highly structured compared to what has happened in France. Amway has quickly integrated Japanese customer's requirements by displaying a limited range of very high quality products. Some of them are being developed in common with local manufacturer such as Sharp, in order to strengthen the company's credibility. Amway has been one of the first direct selling companies to introduce vitamins in Japan. Vitamins represented 24% of Amway sales in Japan, and are one of the drivers of the company's success since consumers are becoming more and more health conscious. The company's sales have risen from ¥75 billion in 1988 to ¥130 billion in 1993<sup>52</sup>. The annual growth of distributors has been 8% and Amway has more than 1,200,000 distributors. Since April 1991, Amway has been listed in the over the counter market at the Tokyo stock exchange, and it is the biggest company listed in terms of sales.

The way Jun Matsunaga describes the functioning of Amway in Japan, doesn't differ substantially from the way network DSO are managed in the US. Distributors are motivated first by the potential amount of money they can earn, and second by the opportunity to develop a network of friends with whom they can share their experience. Amway is helped by the strong hierarchical system of Japanese companies in three ways, in order to recruit, retain and control its network of distributors. First, Amway offers an alternative to the traditional workplace by introducing the concept of entrepreneurship, that is unusual in Japan. Second, because of the traditional Japanese remuneration plan based on seniority, Amway provides a unique opportunity for households to increase their salary. Third, Amway can rely on distributors that are loyal from nature.

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<sup>51</sup>The facts gathered in this section come from my interview with Jun Matsunaga, a MIT Sloan Master student who used to be a member of Amway's network in Japan. 2/9/94

<sup>52</sup>\$1 = ¥130

Amway's Japanese ideology doesn't refer to god, but uses extensively the image of the "American dream" (independence and money) to motivate and recruit distributors. As opposed to France, Amway has benefited from a very disciplined network of Japanese distributors. Very few distributors have taken unethical actions in order to take advantage of their network. This self discipline has helped the company to maintain a good image. Nevertheless, Jun Matsunaga has mentioned that consumer associations and the Japanese government were very attentive to Amway's activity and that Amway's marketing plan has been closely analyzed. Jun Matsunaga also mentioned that many distributors were disappointed by the amount of effort they had to put together, in order to get only a little amount of commission compared to what they were expecting. Although he doesn't have any precise figure about distributors' level of turnover, Jun Matsunaga believes that it is at around 30% per year. Even if he is underestimating the turnover, it seems that the level is lower than the one observed in the United States. Peer pressure seems to be part of Amway's strategy to keep its distributors active since one distributor may be called very often by others to motivate him, if his sales are declining.

### 3) Learning from the experience of network DSO in Japan

According to the description of the Japanese consumer requirements, network DSO seem to be the ideal type of direct selling firms that could succeed in Japan. This is confirmed by the success of Amway in Japan.

Once again the independence that multi-level marketing firms propose appeal to potential distributors. As we now know, multi-level marketing through their home-parties provide the customer with care, and fit totally with the traditional characteristics of making business in Japan. In addition, as opposed to France, direct selling seems to benefit traditionally from a good image in Japan. Thanks to the natural gentleness of the

**Japanese. Amway has been able to manage its network properly in Japan, and the company's traditional psychological tools have been used effectively to control the network. Amway has built a reliable network of direct distributors with whom the company has been able to develop a consumer data base that it exploits as the basis of its direct marketing policy. Amway has been creative enough to adapt its company's culture and ideology to Japan by for example replacing references to religion by references to the American dream.**

## **CONCLUSION**

In most of the countries where network direct selling organizations have set-up business, they have been subject to criticism and their activities have often been viewed as suspicious by government and consumer associations. This study helps us understand that the very specific nature of their business, the way distributors are compensated, the methods used to keep them loyal to the firm, and their communication policy are the source of the overall suspicion. Nevertheless whatever our personal feelings might be towards these companies and the ideology they convey, when they operate legally they are profitable well managed businesses. In addition direct selling through party plan seems to be a good answer to the recent evolution of customers purchasing behavior.

As we have seen, multi-level marketing companies' main assets are their independent distributors and the cultural differences between countries seem to play a very important role in terms of the relationship the company can expect with those distributors. This relationship between the company and its distributors is becoming further more critical for the future of network DSO since the competition has increased within the consumer goods market. In order to achieve a low level of turnover and avoid any unethical behavior, the company must provide its network with an effective remuneration plan. This was confirmed by the analysis of the performances of the distributors. In addition upon the culture of each country the company may utilize a variable blend of ideology to help to keep the distributors faithful, and to promote their products.

Only the organizations that have successfully built a stable and reliable network will be able to create a powerful customer database. By using their database to integrate direct marketing tools in order to support their distributors some firms have built an extremely powerful and reliable distribution channel. We will mention that MCI had used Amway's

**network to commercialize its "family and friends program". In addition to being involved in the consumer goods markets network DSO have built a new competence as a first class provider of distribution network. Legal multi-level marketing companies have still nice days ahead.**

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