

DISCOVERING THE CONTOURS OF DIRECT SELLING IN INDIA

An analysis of the prevailing law

SCOPE

This research paper endeavors to define direct selling more succinctly by differentiating it from various other similar businesses that it is often confused with and how it can be more efficiently regulated. For this purpose, we consider only those businesses that engage with independent contractors.

ABSTRACT

The article deals with three aspects of direct selling business from legal perspective. Firstly, it deals with the major problems that plague the direct selling business, including confusion and overlapping laws while pointing out its benefits. Then the article goes on to emphasize how fraudulent business schemes, which look similar in marketing organization and compensation structure of the direct selling businesses, prevail and tarnish the reputation of genuine direct selling businesses. This is done by indulging in a detailed discussion on the various definitions of direct selling business and related activities that are prohibited by law. The author differentiates among the different concepts to bring clarity to the concept of direct selling business.

Thereafter, the author ventures into a discussion on the prevailing laws that tend to regulate direct selling and prohibit related concepts and the jurisdictional issues it brings up while explaining the problems that the enforcement agencies.

The author finally stretches into a deliberation on the ideal regulator for direct selling businesses and why it is need of the hour.

MAIN BODY

Direct selling is the sale of goods and services directly at the doorstep of the customer. The customer then is absolved from the inconvenience of going to the retail stores. While various models of direct selling prevail in India, there are no set formats for the business models of direct selling companies. This possibility of variation in the models has encouraged entrepreneurs to opt for direct selling more often, resulting in a surge of profits recorded recently throughout the world.¹

Direct selling is not a new concept. The earliest known direct selling business can be traced to the USA, with the establishment of California Perfume company in 1886 which was later renamed Avon (after one of its product lines) in 1939². The response of the market was phenomenal, and it encouraged others to tap new markets for this kind of business model. Soon India also witnessed the ingress of direct selling companies such as Oriflame³, etc. They created raves in the commercial world. After that, there was no looking back for the direct selling industry. Amway,⁴ Tupperware⁵ and Modicare⁶ followed suit and established worldwide empires through direct selling models.

CURRENT SCENARIO

On the Indian terrain, the direct selling business has tapped into the potential of entrepreneurship. As per Indian Direct Selling Association, Indian Direct Selling Industry stood at around INR 1,30,800 million in 2018-19 growing at approximately 13% from INR 1,16,700 million in 2017-18,⁷ and as per The Global Direct Selling 2019 Retail Sales report, India was ranked 15th globally for its record sales via direct selling.⁸ These figures are encouraging and speak volume about the acceptance of direct selling mechanisms in India. Since India is a labour-intensive

¹ Annual Report of WFDSA available at https://wfdsa.org/download/advocacy/annual_report/WFDSA-Annual-Report-2019.pdf

² <https://about.avon.com/us-about/company/history>

³ Registered in India as Oriflame India Pvt.Ltd. on Aug 25, 1994

⁴ Registered in India as Amway India Pvt.Ltd. on Aug 3, 1995

⁵ Registered in India as Tupperware India Pvt. Ltd. on May 1, 1996

⁶ Registered in India as Modicare Ltd. on July 12, 1973. The company commenced business in direct selling in 1995 onwards (See object no.61 to 63 of the MoA of the company which were inserted via amendment on Dec 5, 1995).

⁷ https://idsa.co.in/resources/media/new/1572859797_AS_Exec%20Summary_0.pdf, See also Indian direct selling industry records USD 2.47 bn sales in 2019, ranks 15th globally, Economic Time, July 19, 2020, available at <https://economictimes.indiatimes.com/industry/services/retail/indian-direct-selling-industry-records-usd-2-47-bn-sales-in-2019-ranks-15th-globally/articleshow/77055159.cms>

⁸ Indian direct selling industry records USD 2.47 billion sales in 2019, ranks 15th globally, The Financial Express, July 19, 2020 available at <https://www.financialexpress.com/industry/indian-direct-selling-industry-records-usd-2-47-billion-sales-in-2019-ranks-15th-globally/2028958/>

economy, the availability of human resources at the perusal of businesses is in abundance. However, a unique feature that sets apart direct selling businesses from its counterparts is its ability to employ an otherwise untapped human resource, i.e., homemakers. Most of the time, they are left out from the list of employability/potential workforce due to their commitment at home, cultural predicaments and household responsibilities, including the upbringing of offspring's. All these factors lead to their dismissal from employability and ability to dedicate fixed hours of work on an everyday basis. However, as a representative or an independent contractor for direct selling business, they enjoy the flexibility of work hours along with an extent of commitment, making it conducive for them to earn money without compromising on their other responsibilities.

Similarly, elderly persons, who are usually retired & considered outcasts in terms of available labour force pool, get a second lease of life by participating in this business model. Perhaps this business model is the only model as of now that takes care of gender diversity more than any other. Where the business community was concerned over the statistics that declared "around 53% of top Indian companies have a male to female employee ratio of 10:1 or worse and 70 per cent of the top firms have less than one percent of employees with a disability"⁹, the direct selling business gives a ray of hope wherein "74% of the sales representatives engaged in the direct selling market were women." ¹⁰. Undoubtedly, direct selling balances the scales with a considerable margin by taking care of diversity in terms of gender and age.

Among the various benefits that direct selling business brings to the table, higher employment rate, "financial independence, development of personal and business skills, flexible timings and an improved ability to take care of families are few of the prime ones"¹¹. It has also been observed that "the industry contributes to the exchequer and generates taxes and has the potential solution to several socio-economic challenges... "¹²that the country faces at present.

⁹ Data of 300 out of the top 500 BSE-listed companies in India was analysed for the study by Corporate Responsibility Watch (CRW), a think-tank consisting of 14 civil society organisations. 53% of top Indian companies have a male to female employee ratio of 10:1 or worse, study claims, The Economic Times, Oct 3, 2019 available at https://economictimes.indiatimes.com/news/company/corporate-trends/53-of-top-indian-companies-have-a-male-to-female-employee-ratio-of-10-1-or-worse-study-claims/articleshow/71428589.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst. See also https://www.business-standard.com/article/pti-stories/53-of-top-indian-companies-have-a-male-to-female-employee-ratio-of-10-1-or-worse-study-claims-119100301276_1.html

¹⁰ <https://www.statista.com/statistics/1031657/share-of-people-working-in-the-global-direct-selling-market-by-gender/>

¹¹ Distribution of people working in the direct selling market worldwide in 2019, by gender, <https://www.statista.com/statistics/1031657/share-of-people-working-in-the-global-direct-selling-market-by-gender/>

¹² Direct selling: Kerala, A global industry, empowering millions by FICCI & KPMG 2016 available at <https://assets.kpmg/content/dam/kpmg/pdf/2016/06/Direct-selling-in-Kerala.pdf>

SOCIO-ECONOMIC IMPACT OF DIRECT SELLING

While it is clear from the above discussion how direct selling (DS) is beneficial to all and sundry, one must pause to emphasise the socio-economic impact that DS model has on an economy, especially India. The DS system has tapped the otherwise unexploited human resource available in India, i.e., homemakers, retired persons and even the illiterate and underemployed masses. During the unprecedented times of the pandemic, the DS model helps these persons in continuing to earn a livelihood and keep themselves at bay when the floods of troubled economies hit them. The DS system hands money in the hands of women & senior citizens empowering them with more confidence, financial independence and recognition in the society.

In India, senior citizens, i.e., persons above the age of 60 years are usually about to retire or are already retired from their employment. Between the bread earner retiring and children leaving home, the retired parents are often left to fend for themselves. According to the United Nations, “the number of persons aged 60 and over is increasing at an unprecedented pace, anticipated to rise from its current 740 million to reach 1 billion by the end of the decade” in the world but “two-thirds of the world's older people live in low-and middle-income countries, and this proportion will rise to 80 percent by 2050.”¹³ Given the increasing numbers, the UNHR is already concerned about the increasing poverty, discrimination and health issues that are likely to perplex the economies very soon. It is no wonder then that the current Prime Minister Mr. Narendra Modi has declared ways to provide self-employment to the senior citizens of India by unlocking the potential of the older population of the country¹⁴ because the estimated percentage of senior citizens is likely to increase from 8.6% in 2011 to 19.1% by 2050¹⁵. The DS model brings an ideal opportunity to elevate them from their economic status and positively affect their social status.

The female population is also positively impacted by the DS model as it gives them the opportunity to earn a livelihood without compromising on their home commitments that makes them more confident towards their financial resources and helps in raising the next generation more effectively. It has allowed them to themselves by indulging in public speaking, meeting new people, etc.

The young population is also positively affected by the DS model as it gives them the golden opportunity of sharpening their social skills without requiring any significant qualifications while they learn to stand on their own. Through this exercise, they are learning time management,

¹³ United Nations Human Rights, Human rights of older persons available at <https://www.ohchr.org/EN/Issues/OlderPersons/Pages/OlderPersonsIndex.aspx>

¹⁴ Rs.7,200-crore scholarship plan for reserved class, The Economic Times, January 16, 2020 available at https://economictimes.indiatimes.com/industry/services/education/rs-7200-crore-scholarship-plan-for-reserved-class/articleshow/73286324.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

¹⁵ ibid

teamwork, sharing and learning bright ideas apart from building confidence and honing their stewardship qualities. The enriching experience moulds them into more confident, independent and skilled individuals while helping them earn pocket-money and self-finance their higher studies and giving them the golden opportunity to travel. It brings them more respect from their downline network and stakeholders while helping them build new relationships.

All of these activities combined have a powerful impact on the economy, increasing the GDP, reducing unemployment but more importantly, bringing those into the frame who were otherwise discarded as non-productive labour forces or often considered liabilities in the families.

CONCEPT OF DIRECT SELLING BUSINESS

Our country grapples with several challenges where the idea of having offspring and expanding families is a mandatory stage of life and not an option—the pressure on earning members increases. Since joint families are a prominent feature in semi-urban and rural areas of India, the mouths for feeding are more whereas the earning members are few and are usually confined to fixed incomes. The idea that the women of the household, youth & elderly can earn to add to the pool of income available was a ground-breaking and empowering idea, all thanks to the concept of direct selling business.

The concept of direct selling business does not enjoy any universally accepted definition. So much so that the Indian legislations have only recently endeavored to define a direct selling business, i.e., as late as in 2019. As mentioned before, the direct selling business does not have any straitjacket formula. The Consumer Protection Act defines direct selling as “marketing, distribution and sale of goods or provision of services through a network of sellers, other than through a permanent retail location.”¹⁶

The determination of a business as a direct selling one will depend on various factors discussed here:

a. Business must be selling a product/service that adds/brings value to the customers: If a business does not sell any product or service or sells a product or service that is of no use to its customers, it is not a direct selling business but a mere facade'. For example, Social Trade Biz claimed to promote likes that in reality, delivered no value to its participants /customers and were later declared scams by the court. Speak Asia¹⁷ and TVI Express¹⁸ are other examples. There may

¹⁶Section 2(13) of the Consumer Protection Act, 2019

¹⁷Speak Asia promoter held 2200 crores Times of India, Nov 27, 2013, <https://timesofindia.indiatimes.com/india/Speak-Asia-promoter-held-for-Rs-2200-crore-scam/articleshow/26434497.cms>

also be cases where the entity disguises money circulation by introducing token products such as recharge portals, e-learning, websites, webspace, holiday vouchers, etc. which are not used by the customers or provide no actual value to the customers.

b. No retail stores or retail stores are secondary: Since direct selling depends on personal interactions wherein person-to-person marketing is the prime method of marketing, retail stores, i.e., brick and mortar shops/outlets are usually not established by the DS company. For instance, Meesho, which provides social commerce platforms to wholesalers, is an online service provider but also has independent contractors to promote the products. Amway has experience centres in brick-and-mortar that help customers experience the products and services without setting up selling counters. Once the customer is interested, he can contact the direct seller known to him or one who is conveniently located near him.

c. Engagement of independent contractors: A direct selling company engages individuals to represent the company through a contract for service who are in the nature of independent contractors & who are appointed to sell and demonstrate products/services to the prospective customers and who may or may not be allowed to introduce others to the business. There is no direct control of the direct selling company over the independent contractors in terms of their working or timeframe of performance or any other supervision for that matter. They are compensated for the products or services they sell and are free to walk away from the arrangement as and when it is convenient. A direct selling company must essentially have independent contractors. If the representatives it hires are not independent contractors but employees, it would be a direct marketing company and not a direct selling company.

d. Usage of personal network and contacts to sell products: The direct selling model provides for accessing a more expansive network whereby direct sellers use their contacts and acquaintances to sell products/services. This sales network widens with an increase in the number of independent contractors.

e. Personal interactions are usually a part of the transactions: More often than not, personal interactions take place whereby the products/services are demonstrated & explained by the independent contractor to the prospective customer at his convenient place and time. This personal access to goods and services as samples/demonstration provides the customer with an opportunity to perceive, try, feel and test the good/service first-hand, helping him to make an informed decision regarding the purchase of the goods/service.

¹⁸TVI Express, yet another Speak Asia? Money Life, May 27, 2011 <https://www.moneylife.in/article/tvi-express-yet-another-speak-asia/16795.html>

There are primarily three kinds of direct selling models ¹⁹based on compensation plans and marketing organisations i) Direct ii) Single level marketing and iii) Multi-level marketing. ²⁰ Compensation plans turn out to be the ultimate determinants of the model since they are deciding factors for marketing organisation structure too.

The entities could opt for a direct compensation plan where the seller gets compensated for his personal sales in a defined tenure in which case the marketing organisation is 'direct' since there is no incentive for the seller to recruit or introduce anyone.

Whereas in case the entity opts for a single level compensation plan, where the seller not only gets compensated for the sales, he performs in a defined tenure but also gets compensation on the sales performed by the sellers he had introduced himself who are placed in his first-generation. Here, the compensation plan will be termed as 'single level', but in this case, the marketing organisation will be multi-layered/level.

In case the entity opts for a multi-level marketing plan, where the seller/participant/investor not only gets compensated on his personal sales/investment but also (if eligible as per certain conditions in the compensation plan) the sales/investment of the sellers he had introduced who are placed in his first-generation and the sellers who are introduced by the sellers introduced by them and onwards, the compensation plan will be termed as 'multi-level', and the marketing organisation is also multi-level. Since earning is high, these types of business models are inevitably prevalent in India and across the world.

PROBLEMS IN DEFINING DIRECT SELLING BUSINESS

All said and done, the greatest virtue of direct selling also becomes its greatest vice. Since there are so many fluid structures of DS business model possible (depending on different permutations and combinations of compensation plans, marketing organisation structure, business vehicles, etc.), the variety that it offers makes it difficult to be identified as a direct selling mechanism²¹. Though by and large, countries do agree on certain features of direct selling, there has been no uniform definition of direct selling. According to the Federal Trade Commission of USA, "direct selling is a blanket term that encompasses a variety of business forms premised on person-to-

¹⁹ For further reading see Strategy India, Hierarchy of a Direct Selling Company, available at <https://www.strategyindia.com/hierarchy-of-a-direct-selling-company.html>

²⁰ William W. Keep and Peter J. Vander Nat (2014), Multi-Level Marketing and Pyramid Schemes in the United States: An Historical Analysis, *Journal of Historical Research and Marketing*, 6(2), 688-210 at p.189. See also Strategy India, MLM Systems - The modern-day pyramids available at <https://www.strategyindia.com/mlm-systems-the-modern-day-pyramids.html>.

²¹ See StrategyIndia's parameters to determine unviable business plans operating in the garb of direct selling companies [parameters](#)

person selling in locations other than a retail establishment, such as social media platforms or the home of the salesperson or prospective customer."²²

Few scholars have defined DS as "Direct selling is face-to-face selling away from a fixed retail"²³ which, unfortunately, does not give any clarity on the concept.

The Direct Selling Guidelines, 2016 define direct selling "marketing, distribution and sale of goods or providing of services as a part of a network of Direct Selling other than under a pyramid scheme... provided that such sale of goods or services occurs otherwise than through a 'permanent retail location' to the consumers, generally in their houses or at their workplace or through explanation and demonstration of such goods and services at a particular place."²⁴ As may be apparent from this definition, using the term 'direct selling' while defining the concept of direct selling and using it to build a definition is not the most prudent way of defining a term. This term, therefore, confuses a reader instead of providing clarity.

As part of the conditions under the Guidelines, a direct selling organisation must be a 'registered entity under the laws of India. However, if an entity is a sole proprietorship, it does not require any registration, nor any law caters to a voluntary registration of sole proprietorship firms. So, these firms may find themselves in violation of the Guidelines. Similar may be a case for traditional partnership firms who have chosen not to register (since registration is not mandatory under the Indian Partnership Act, 1932) who will have to register (along with compliance with other requirements) in order to qualify to be termed as a direct selling entity under the Guidelines.

DIFFERENTIATING DIRECT SELLING BUSINESS MODEL FROM OTHER SIMILAR FRAMEWORKS

The creature of direct selling is commonly known by several names though technically wrong. Network marketing, personal marketing, person-to-person selling, referral marketing, even MLM, multi-level marketing, etc. are all used to refer to the same business model, i.e. direct selling. However, there are several other business mechanisms that must be distinguished from direct selling in order to establish the real character of DS. From amongst the catena of business models, the following are the two main models that DS is often confused with:

1. Difference between direct selling business and pyramid schemes:

²² Federal Trade Commission, Business Guidance concerning Multi-level marketing available at <https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing>

²³ Robert Peterson and Thomas Wotruba, what is Direct Selling? - Definition, Perspectives, and Research, Journal of Personal Selling & Sales Management, Fall 1996

²⁴ Clause 1(6) of the Guidelines.

UK Consumer Protection from Unfair Trading Practices Regulations 2008 prohibits pyramid schemes by explaining them as "promotional schemes where a consumer considers an opportunity to receive compensation that is derived primarily from the introduction of other consumers into the scheme rather than from the sale or consumption of products."²⁵ As per this definition, the pyramid schemes should have the following features to fall into the category of unlawful activities:

- A. It must involve a "consumer"²⁶ who has paid an amount to avail the opportunity,
- B. The consumer must have provided a "consideration."
- C. That consideration must have been given for an opportunity to receive compensation. (compensation here refers to remuneration or commission)
- D. That compensation must be "derived primarily from the introduction of other consumers"²⁷ into the scheme rather than from the sale or consumption of products".

From the above features, it is clear that a pyramid scheme is one where the sole basis for earning commission is the introduction of other consumers to the scheme and not any sale of goods or service. For instance, a scheme that proclaims that "Join Scam Scheme. It will cost you £400"...then you will be in line to earn a commission from persuading others to join the scheme. You will receive no commission in respect of those whom you recruit, but you will receive a commission of £100 in respect of each of those whom they in turn recruit. So, if you recruit four people and they each, in turn, recruit four people, you will receive £1600".²⁸ It is a pyramid scheme as per Indian standards because the commission is based on mere introductions and not for the sale of goods or services.

One must note that it is immaterial whether such opportunity is availed or not. If a participant pays only to avail an opportunity with or without receiving any goods or service in exchange for its consideration, it will be termed as a pyramid scheme. An obvious doubt arises w.r.t the compensation/commission in this context. What is the determination of a model if a specific portion of the total compensation is derived from recruitment while the other portion is derived from the sale of product/service?

As per this definition, the entire amount of compensation should be derived from the sale of goods/service, and where even a small portion of the commission is relatable to the recruitment, the entire business model will be termed as a pyramid scheme as per this definition.

It would nearly turn all direct selling businesses as pyramid schemes! And therefore, we cannot rely on this definition for our analysis.

²⁵ Item 14 to Schedule 1 of the Consumer Protection from Unfair Trading Practices Regulations 2008, of the United Kingdom

²⁶ It may be assumed here that the word 'consumer' would include 'customer'.

²⁷ *ibid*

²⁸ Paul Dobson, Does the ban on pyramid promotional schemes challenge the business model of a typical direct selling company. *Journal of Business Law*, 2011, 2, 194-207.

In India, the definition of a pyramid scheme has been provided under the Direct Selling Guidelines, 2016. It defines a pyramid scheme as "a multi-layered network of subscribers to a scheme formed by subscribers enrolling one or more subscribers in order to receive any benefit, directly or indirectly, as a result of enrolment, action or performance of additional subscribers to the scheme. The subscribers enrolling further subscriber(s) occupy the higher position and the enrolled subscriber(s) lower position, thus, with successive enrolments, they form a multi-layered network of subscribers".²⁹ As per Koscot, a case before FTC, unlawful businesses are "characterised by the payment by participants of money to the company in return for which they receive (1) the right to sell a product and (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to the sale of the product to ultimate users."³⁰

In order to distinguish between a pyramid scheme from a direct selling model, one must observe that a pyramid scheme is a multi-layered network while direct selling may or may not be.

A pyramid scheme is also usually an unsustainable business model. A scheme may be dependent on new joinees' income from the sale of products/joining fee to pay off the commissions of the earlier joinees in a pyramid. The earlier joinees are stationed higher in the hierarchy and are likely to get more income from the source of income (joining fee or sale of products, as the case may be).

Another kind of pyramid scheme is where the products/services are involved, and it is the compulsion/incentive/bait to purchase excessive quantities of products/services that make the entire structure collapse because of it being unsustainable.

Thus, the difference will be carved out only on an analysis of the business plans.

2. Difference between direct selling and direct marketing

Direct selling is more about selling than marketing, and this emphasis helps us differentiate direct selling from any other form of marketing per se. Direct marketing is simply "the marketing of goods and services directly to consumers through the use of the telephone & non-personal media to communicate product and organisational information... who then can purchase them via mail, telephone, or internet".³¹ Sales personnel in direct selling organisations are considered to be independent contractors as against direct marketing where salespersons are usually employees of the organisation.

3. Difference between direct selling and money circulation schemes

²⁹ Clause 1(11) of the Direct Selling Guidelines, 2016.

³⁰ In re Koscot Interplanetary, Inc., 86 F.T.C. 1106, 1181 (1975)

³¹ Lawrence B. Chonko, Thomas R. Wotruba and Terry W. Loe, Direct Selling Ethics at the Top: An Industry Audit and Status Report, The Journal of Personal Selling and Sales Management, Spring, 2002, Vol. 22, No. 2 (Spring, 2002), pp. 87-95 at p. 87

Money circulation scheme is one in which "the verbal or written commitments are not arithmetically sustainable and/or may or may not be related to the sale of goods/services by the participants engaged or the participants below them in their marketing organisation. This type of scheme is partly/entirely dependent on new investments for the earnings committed"³² In other words, it is a scheme which depends on new participants to fulfil the commitments made via the compensation plan to the participants who joined earlier. At the same time, a genuine direct selling business model will always be sustainable and will have a fixed percentage from the sale of products earmarked and committed for distribution. It is different from a direct selling business in the sense that like pyramid schemes, money circulation schemes are also unsustainable business models while direct selling businesses are not.

OVERLAPPING LEGISLATIONS & JURISDICTIONS AMIDST CONFUSION OF DEFINITIONS

There are various parameters to adjudge a country's legal regime as to whether it is conducive for a business environment or not, such as fairness, accessibility, dispute resolution, entry and exit of players, etc. Among these, one of the most important tenets for encouraging business is a certainty of law. This, unfortunately, is found lacking in the area of direct selling business though there are at any given time more than 600 MLM operations in India promoting products along with more than 1000 fraudulent schemes³³. Whether a business is a genuine MLM business or is it an unsustainable one, there are no clear definitions, rules or regulations.

The Direct Selling Guidelines, 2016 provides a disorienting definition wherein a pyramid scheme is one which is not a direct selling business, and direct selling business is one which is not a pyramid scheme. The definitions, therefore, lead to confusion.

To add to the sorrows of the enforcers and businessmen, the PCMCS(B) Act, 1978 prohibits any benefit or payment which are collected directly or indirectly from the recruitment of new participants/members. However, the Direct Selling Guidelines explains those businesses as genuine where commission /earnings are from recruitment as long as there is a sale of products. This blurring line between what amounts to a genuine transaction and which one does not has caused plenty of uncertainty.

Under the definitions, a pyramid scheme has been described,³⁴ and the proviso to the definition guides the enforcer not to confuse a pyramid scheme with a genuine MLM or direct selling operation. The guidance prescribes that the "definition of a 'Pyramid Scheme' shall not apply to a

³² Strategy India, Commonly used terms in Direct Selling available at <https://www.strategyindia.com/mlm-guidelines-1.html>

³³ As per the statistics available on Strategy India at <https://www.strategyindia.com/blog/scam-alerts/>

³⁴ Clause 1(11) of the Direct Selling Guidelines, 2011

multi-layered network of subscribers to a scheme formed by a direct selling entity, which consists of subscribers enrolling one or more subscribers in order to receive any benefit, directly or indirectly, where the benefit is as a result of the sale of goods or services by subscribers" and the scheme/financial arrangement complies with all of the conditions provided therein which are summarised as follows:

- a) It has no promises for the participant that he will receive remuneration/incentives for the recruitment or enrolment of new participants.
- b) It does not require the purchase of goods/ services by participants at an exorbitant price nor a sale/consumption/resale that exceeds an amount that can be expected to be consumed by or sold or resold to consumers. Here, if the amount to be paid by the direct seller is unnecessarily high or the quantities to be sold are unreasonable, that burdens the direct seller, making the structure unsustainable, it would amount to a pyramid scheme. The clause does not guide as to what would amount to an exorbitant price, nor does it throw light on the period that must be taken into account to determine such exorbitant prices. It leaves the term open to interpretation.
- c) It does not require a participant to pay any entry/registration fee or bear any cost for sales demonstration equipment & materials or any other kind of fee relating to participation. This clause may attract litigation at a later stage because it does not clarify as to 'when' it cannot be charged. For instance, if the price of the product sold to the direct seller is increased marginally to cover the fee that would have been otherwise charged, the scheme would easily pass as a genuine business plan while it is just camouflaging the participation fee in the form of the product's price and is actually a pyramid scheme.
- d) It provides participants with a written contract describing terms related to the compensation plan, etc.
- e) It provides a reasonable cooling-off period to participate or cancel participation in the scheme. The word 'reasonable' is subject to interpretation and clarification in this regard would have been useful.
- f) It provides for refund of any consideration given to participate in the operations.
- g) It provides for a policy of buy-back or repurchase for marketable goods/services sold to the participant at his request at reasonable terms. The word 'reasonable' should have been inserted with an explanation that provides sufficient guidance to the direct sellers, direct selling entities and other stakeholders.
- h) It establishes a grievance redressal mechanism for consumers. The usage of the word 'consumers' would exclude the participants who purchase specific quantities of products every month/periodically in order to earn/ qualify for overriding commissions. In such cases where participants purchase products but do not use them, they are only 'customers' and not 'consumers'. However, since the constitution in this clause confines the availability of a grievance redressal system only to consumers and not for customers, the participants would not have any platform for raising their concerns/grievances and yet it would qualify as an entirely genuine business plan.

While this is the first time that the government has attempted to define direct selling and pyramid schemes, the effort has not been entirely successful for various reasons.

Firstly, guidelines prescribed after such a long wait by the industry, lawyers and consumers are mere guidance for the direct selling businesses and the provisions cannot be enforced. It has been left to the concerned state governments to ponder over the matter and convert it into a binding law because the Guidelines are merely "guiding principles for State Governments to consider regulating the business of Direct Selling and Multi-Level Marketing (MLM)".³⁵ However, in the age of technology and the internet where no business is circumscribed by geographical territory, the state governments will find it extremely challenging a task to actually enforce these provisions, especially when the other state concerned may not have adopted these guidelines as binding law. The government should consider issuing byelaws, even if by virtue of rules to make the guidelines enforceable and for effective regulation.

Secondly, since the only basis of differentiation between direct selling business and pyramid scheme under the Guidelines is based on the definition of a pyramid scheme, the pyramid scheme should have been precisely defined. However, many genuine direct selling businesses may be tarnished in the wake of the current description. This is so because various schemes can be passed off as genuine under the current description when the fraudulent entities may dangle a carrot before the participants by tempting them that they will be entitled to an overriding commission for the performance of their downline network if they will comply with extra (quantities that they will not be able to sell or consume) purchases/sales/resales etc. However, they will not be captured by the current definition because the overriding commission is neither based on mere recruitment of the downline network nor based on the purchase of "unexpected" goods/services. The legislators ought to introduce more precise definitions and organise awareness programmes for the public (including service providers who are engaged by the direct selling companies to provide services such as preparing software's, web designs, etc.) to educate them as to how to differentiate between genuine and non-genuine business models. The internet as a medium can be used, and large-scale workshops for police personnel can be organised to help them differentiate between the two, equipping them with different tools including standard operating procedures and knowledge from various jurisdictions. If the enforcement agencies are well-trained to detect frauds and engage in proactive roles, the frauds in this sector will automatically diminish.

Various experts of the field have expressed their disappointment with the definition of the 'pyramid scheme' and direct selling business. Pranjali R Daniel, a direct selling expert, has emphasised that the basis of the distinction between the pyramid scheme and direct selling business should not be made superficially as is enunciated in the Guidelines. Instead, he is of the

³⁵https://consumeraffairs.nic.in/sites/default/files/file-uploads/direct-selling/Direct%20Selling%20Guidelines%20Final%20_0.pdf

view that the litmus test for determining a scheme's identity is by going through its business plan. If a business plan is sustainable, it is a genuine scheme, but if it is unsustainable and is likely to collapse in due time, it should be termed as a pyramid scheme.³⁶ A cue can also be taken from the Federal Trade Commission (FTC),³⁷ which considers this determination as fact specific. According to FTC, in order to differentiate between genuine and deceptive MLM businesses, following parameters are used - i) operation of the structure in practice; ii) marketing representations; iii) experiences of the participants; iv) compensation plan; v) incentives as laid out in the compensation plan³⁸vi) behavior promoted by the said compensation plan. Only such a comprehensive analysis will yield the true nature of a business model.

This exciting aspect of detailed analysis can actually hold the key to the solution. A regulator, if in place, can, at the time of registration, evaluate the business model of the entity in order to find out whether it is sustainable or not and parameters for checking sustainability can be issued as an advisory by the government. This preventive measure can be useful in two ways- i) it will prevent massive scale frauds from taking place by nipping them in the bud; and ii) it will help the monitoring agency in creating a central database for persons/entities who have been attempting to register pyramid/money circulation scheme, identifying delinquent offenders and it will also help develop universally applicable parameters over a period of time.

Thirdly, the scheme can also be confused with money circulation schemes and no endeavour has been made to distinguish pyramid schemes and money circulation schemes. However, both are very different creatures and ought to be defined more succinctly so that the general public and enforcement authorities have clarity on the concepts and can investigate & seek evidence accordingly. Broadly, there are three main differences between money circulations schemes and pyramid schemes:

- i) Money circulation scheme is always unsustainable, but a pyramid scheme can be both sustainable as well as unsustainable, making it more enigmatic in nature.
- ii) The structure of a Pyramid Scheme is always a multi-layered network, a feature also identified in the definitions across the world, whereas in a Money Circulation Scheme, the marketing organisation structure of any form. For instance, Speak Asia was a multi-level organisation as compared to Saradha,³⁹ which was a single level marketing organisation, but both were money circulation schemes.
- iii) In a Pyramid Scheme, mostly person at the top of the chain of hierarchy earns the highest, and person at the lower rank feeds the system, just like the pyramids of Giza whereas, in a

³⁶ An interview with Mr. Pranjal Daniel, Chief Strategist at Strategy India on September 19, 2020.

³⁷ The regulator for direct selling business in the USA.

³⁸ Federal Trade Commission, Business Guidance concerning Multi-level marketing, available at <https://www.ftc.gov/tips-advice/business-center/guidance/business-guidance-concerning-multi-level-marketing>

³⁹ M.A. Arawatia and V. Pande, A study of Ponzi scheme with reference to Saradha scam, International Journal of Science, Technology and Management, Vol 5, Issue 2, Feb 2016

money circulation scheme, the person at the top may not be earning the highest since they may not operate in the form of a pyramid.

iv) The Compensation plan in a money circulation scheme can be of any kind including direct, single-level or multi-level, but the compensation plan in Pyramid Scheme is always of a multi-level nature.

These differences, apart from others, if kept in mind, one can easily differentiate between money circulation schemes and pyramid schemes. However, much to the chagrin of the business community, this distinction is not aptly reflected in the definitions of the concepts.

Fourthly, as per Guidelines, the definition of consumer is referred to the one as described under the erstwhile Consumer Protection Act, 1986 and not as per the Consumer Protection Act, 2019. Even after the enforcement of the Consumer Protection Act, 2019, the Guidelines have not been amended and the direct selling business community, as well as the enforcement agencies, are stuck with the old definition of 'consumer' wherein the word 'consumer' does not include direct sellers. This application of the old definition of consumer causes plenty of confusion. This will require only a clarification to be issued by the Ministry, and the problem can be resolved at once.

Fifthly, the Guidelines do not define 'customer' nor does it differentiate between 'consumer' and 'customer', which at times becomes very significant. While 'customer' is a person who purchases a good/service and pays a consideration for it, a 'consumer' is one who consumes the good/service. It becomes often complicated as to who has the locus standi to sue since there may be a situation where the customer is not the consumer. In such a scenario, a business entity can technically question the institution of the suit on the basis that the contract of sale was between the customer and the entity/vendor, and the consumer was a third party to the contract and therefore not privy to it. Consequently, the consumer will not be able to sue the entity for damages because there was actually no contractual relationship between them. For instance, I purchase a cosmetic product which promises rejuvenation of the skin. If I gift it to an office colleague and she consumes it only to learn that her skin is disfigured, will she be able to sue the manufacturer? Similar is the case with a borrowing of goods/services that have been purchased by another. Although the consumer forums have been sympathetic to the cause of the consumers and have allowed such suits to be instituted, it will only take a shrewd lawyer to turn the tables and point out this technical nuance, absolving business entities of all obligations in any such cases. On similar lines, when an NGO purchases air purifiers with negative ion generators, claiming to terminate the COVID 19 virus in the air and that NGO donates these purifiers to a hospital, in the case where the claims are false, and the purifier does not perform any such function, the hospital will find it difficult to sue the air purifier manufacturer because it was the consumer but not the customer and would not have any locus standi since it was not privy to the contract of sale.

The legislators must define and differentiate between the two in order to provide adequate remedies. Including definition in byelaws, rules or regulations will not help. The definition should be included in the Act itself where other appropriate amendments should also be made to recognise the difference between the two terms and to provide effective remedies to them. A remedy to customers may not be the same as it is for consumers. A customer would benefit from *restitutio in integrum* while the consumer may have to be compensated with exemplary damages.

Sixthly, the Guidelines put the onus on the direct sellers to fulfil many obligations that they actually may not comprehend. One must not forget that direct selling business is one of the few business streams that allow persons of all ages, any or no qualifications, etc. to do business and earn their living. So, an obligation, even if enforceable, would require huge awareness campaigns on the part of the government and the direct selling companies to educate the direct sellers in this regard. As of now, neither the obligations are backed by any consequence, making them persuasive but not mandatory, nor any monitoring/regulatory agencies have been set up in order to find out whether the direct sellers are actually able to comprehend and effectuate the obligations under the Guidelines. The ultimate result of such inaction is that the direct selling companies end up bearing the brunt for the ignorance of the direct sellers. As mentioned before, the government should organise awareness camps to empower direct sellers and customers alike.

In short, the Guidelines have left much to be desired. However, that is just the tip of the iceberg. As of now, there are three main legislations that have overlapping jurisdiction w.r.t. direct selling, albeit accidentally and more often than not, erroneously. These legislations are:

- a) PCMCS(B) Act, 1978 along with Money Circulation Scheme (Banning) Rules, 2013
- b) Banning of Unregulated Deposit Schemes Act, 2019
- c) Consumer Protection Act, 2019
- d) State legislation such as Tamil Nadu Protection of Depositors (Financial Establishments) Act 1997, Maharashtra Protection of Interest of Depositors (in Financial Establishment) Act, 1999 and Odisha Protection of Interests of Depositors (in Financial Establishments) Act, 2011 among others

These legislations often find themselves dealing with MLM businesses. For instance, PCMCS(B) Act bans money circulation schemes that deceive its participants by defining money circulation scheme as one "... for the making of quick or easy money, or for the receipt of any money or valuable thing as the consideration for a promise to pay money, on any event or contingency relative or applicable to the enrolment of members into the scheme, whether or not such money or thing is derived from the entrance money of the members of such scheme or periodical subscriptions."⁴⁰The confusion is mostly due to the expression "on any event or contingency relative or applicable to the enrolment of members into the scheme" which would

⁴⁰ Section 2(c) the PCMCS(B) Act

technically capture all circumstances where direct selling business offer single-level and multi-level compensation, based on the enrolment of new direct sellers' sales numbers. If seen broadly, an enforcement agent may end up concluding that since the direct selling company is actually offering an increased incentive to a direct seller if his downline network sells more products/services, what the direct selling company is giving is eventually an indirect outcome of more number of recruited direct sellers in the downline network. This erroneous interpretation would end up dragging an innocent direct selling business to the courts, where even if they prove that theirs is a genuine business with a sustainable business model, their reputation would have already been tarnished. There would be no *restitutio in integrum* for the impugned entity.

The aftermath of Saradha fraud⁴¹nudged the government to take action. Since the PCMCS(B) Act,1978 is a legislation that is to be enforced by the state governments, after a gap of approximately four decades, the central government finally drafted a set of rules for the state governments that they could notify wherein pyramid schemes were defined. This definition is the same as the one which has been incorporated under the Guidelines of 2016.

The Consumer Protection Act has also put the onus on the direct selling entities who fall within the category of e-commerce platforms. These entities are required to meet with several requirements in order to continue using electronic platforms⁴².

Banning of Unregulated Deposits Act, 2019 (BUDA) deals with transactions which are in the nature of 'deposits'.⁴³ The purpose of this Act is to legislate, delineate and define authorities with respect to an "Unregulated Deposit Scheme" which is defined as a Scheme or an arrangement under which deposits are accepted or solicited by any deposit taker by way of business and which is not a Regulated Deposit Scheme, as specified under column (3) of the First Schedule. Few state-level legislations have also surfaced in order to curb the menace of fraudulent deposits taken by companies who do not have permission or license from concerned authorities.⁴⁴However, due to a lack of understanding of the concepts, the enforcement authorities are not able to use these enactments optimally. The uncertainty of when this enactment will be applied or when it should be replaced by the PCMCS(B) Act,1978 is not apparent. If a direct selling company is not involved in genuine business activities, the enforcement agency is caught in a dilemma whether to book the accused under the PCMCS(B) Act or under BUDA. While the PCMC (B) Act,1978 is a state-based enforcement mechanism, BUDA has a pan-India application. Since the fraudulent business, in the garb of direct selling business, can take any form, the enforcement agencies and judiciary should be equipped with

⁴¹ Refer to Footnote 39

⁴² Rule 5 of the Consumer Protection (E-commerce) Rules, 2020

⁴³ Section 2(4) of the Banning of Unregulated Deposit Schemes Act, 2019

⁴⁴ See for example MP BUDA Act Rules, 2020 and The Maharashtra Protection of Interest of the Depositors Act that came into force in 1999.

'determining tools'⁴⁵ in order to ascertain as to what enactment shall apply. This will reduce the ordeal of the victims and save the time of both courts and enforcement agencies. For instance, in the recent IMA fraud, the accused persons have been booked under The Karnataka Protection of Interest of Depositors in Financial Establishments Act, 2004⁴⁶. The prime challenge that the enforcement agency will face before the court is the confinement of jurisdiction. The fraud has affected persons living in Hyderabad, Maharashtra and Uttar Pradesh, among other places. In such a case, a law which is only confined to Karnataka may not give appropriate relief to the victims of other states.

That being said, overall, there is an air of uncertainty and confusion concerning the direct selling companies, the confusion that prevails with respect to the multi-level marketing companies and confusing them with their evil look-alike, the pyramid schemes/MCS.

REGULATORY HUSTLE FOR DIRECT SELLING BUSINESSES

India has witnessed some enormous scale frauds where the perpetrators of the crime had used the MLM model of business in order to lure persons from all walks of life. Since "easy-multiplying of money" is usually the undercurrent of a nefarious scheme and does not require any qualifications as a prerequisite for becoming a participant in the scheme, one can imagine the extent of crowd it may attract if rightly manipulated and advertised. Whether it be IMA scheme of Karnataka⁴⁷ or the Saradha scam of Kolkata,⁴⁸ the magnitude of the fraud, especially looting money by befooling people into investing their life savings and hard-earned money apart from exploiting the goodwill of individuals, the scams did make us question why direct selling business is not being regulated more effectively. Instead of waiting for frauds to take place, a developing country like India, where a significant population is illiterate, and below the poverty line, the economy suffers from high inflation. Where the banks guarantee low rates of interest, the country must have a robust regulator in place to prevent such frauds from taking place instead of acting post facto because *restitutio in integrum*⁴⁹ becomes nearly impossible.

As very often misunderstood, usually all MLM models do not tantamount to illegal schemes. The media has added to this confusion who often erroneously call MLM businesses as equivalent to fraudulent schemes and use these terms interchangeably. Several MLM businesses are

⁴⁵ Could be in the form of a checklist or guidelines for application of the relevant enactment.

⁴⁶ IMA scam: All you want to know about ponzi scam in Bengaluru , The Times of India, Dec 24, 2019 available at <https://timesofindia.indiatimes.com/india/ima-scam-all-you-want-to-know-about-ponzi-scam-in-bengaluru/articleshow/72950311.cms>

⁴⁷ *ibid*

⁴⁸ M.A. Arawatia and V. Pande, A study of Ponzi scheme with reference to Saradha scam, International Journal of Science, Technology and Management, Vol 5, Issue 2, Feb 2016

⁴⁹ In the civil law, it means restoration or restitution to the previous condition; putting things back the way they were, originally a remedy in Roman law allowing a party to be restored against his own deed.

sustainable and successful such as Amway, Oriflame, Modicare that are multi-level marketing organisational structure (with multi-level compensation plans) and have genuine businesses.

In order to ascertain an MLM business whether it is genuine or a fraudulent one, there are usually three elements that can help one discover, a determination that has a significant effect on the outcome of the case.

Most commonly, MLM models are looked down as 'money circulation schemes' under Prize Chits and Money Circulation Schemes (Banning) Act, 1978.⁵⁰ As of today, the PCMCS(B) Act fails to distinguish sustainable business models of MLM (based on effort-based earning) from fraudulent schemes. Genuine direct selling representatives have been arrested from time to time only for the reason that the enforcement agencies could not differentiate appropriately, and no law exists to aid them in telling the two apart.⁵¹ Several pronouncements of the Supreme Court of India have also clarified that the MLM models do not fall into the category of PCMCS(B) Act.⁵² However, regulators such as the Reserve Bank of India have themselves often erred in differentiating between genuine MLM businesses and pyramid schemes. A testimony to this fact is the warning issued by the Reserve Bank of India in 2015 against pyramid schemes that promise easy money. The central bank used phrases such as "explaining the functioning of these entities, the Reserve Bank stated that MLM/Chain Marketing/Pyramid Structure schemes promise easy or quick money upon enrolment of members..." ... and "Reserve Bank has advised that members of the public should not be tempted by promises of high returns offered by entities running Multi-level Marketing/Chain Marketing/Pyramid Structure Schemes. "... because "acceptance of money under Money Circulation/Multi-level Marketing/Pyramid structures is a cognisable offence under the Prize Chit and Money Circulation (Banning) Act 1978." .⁵³ If one notices the language of the press note, one can easily comprehend the lack of difference that exists in the mind of RBI w.r.t to MLM schemes and pyramid schemes. Generalising all MLM businesses as fraudulent activities and asking the public to be cautious against all MLM businesses adversely affects the reputation and morale of persons engaged in ethical MLM business models. It is inevitable then that the public remains as confused as the financial regulator itself.

In order to understand the entire web of laws and regulatory structure around DS, especially those businesses which rely on friends, relatives and acquaintances to increase their outreach, we must start from the beginning.

⁵⁰ Section 2(c) of the Act

⁵¹ See for instance Another arrest for Amway India CEO in Andhra Pradesh, The Economic Times, Sept 12, 2018 https://economictimes.indiatimes.com/industry/services/retail/another-arrest-for-amway-india-ceo-in-andhra-pradesh/articleshow/35854314.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

⁵² Such as State of West Bengal v Swapan Kumar Guha (1982) 1 SCC 561; Srinivasa Enterprise v UOI (1980) 4 SCC 507; Reserve Bank of India v Peerless Co (1987) 1 SCC 499

⁵³ RBI cautions Public against Multi-Level Marketing Activities, Reserve Bank of India, January 1, 2015 available at https://www.rbi.org.in/Scripts/FS_PressRelease.aspx?prid=32908&fn=2745

The chit funds and money circulation schemes are captured under Entry 7 of Concurrent List in Schedule VII to the Constitution of India under the category of 'contracts'⁵⁴ and not under the Entry 30 of the State list⁵⁵ which deals with money lending because of the nature of transactions where the money is invested in gaining a chance to win. PCMCS(B) Act of 1978 was enacted to prohibit illegal chit funds schemes. As per the enactment, state governments were to shoulder the responsibility to enforce the Act by making rules. Thereafter, the Central Chit Funds Act, 1982 was passed to regulate chit funds more effectively⁵⁶ under which the Union government may choose on its own to notify the Act in respective states at different times. If the government decides to notify the Act in a state, the state enactment shall stand repealed. States are responsible for notifying rules and have the power to exempt certain chit funds from the provisions of the Act.

However, as mentioned earlier, direct selling business, which includes multi-level marketing, is different from chit funds and pyramid schemes and therefore not necessarily regulated by the PCMCS(B) Act for the simple reason that PCMCS(B) Act frowns upon any activity which falls within the category of chit funds, prize chits, an unsustainable financial scheme or any creatively designed fraudulent multi-level marketing scheme that are hollow when it comes to sale and provision of goods or services. In other words, the PCMCS(B) Act merely speaks about a certain kind of fraud that can be perpetrated using the direct selling model (especially multi-level marketing model) but goes no further. Therefore, the need for a dedicated regulator and law has been felt for a long time.

Although the DS model is regulated by different regulators in different dimensions, there is no dedicated regulator for the direct selling companies. Here the different regulators are mentioned that regulate the direct selling businesses from different perspectives:

Ministry of Corporate Affairs: The business vehicle that carries the business of direct selling whether multi-level marketing or not, are usually companies or partnership firms, though limited liability partnerships and sole proprietorship firms are also alternatives available. Irrespective of the kind of business vehicle chosen, the regulator for commercial vehicles is the Ministry of Corporate Affairs. Dedicated legislation, therefore, will be the regulating guide for the companies, but only to the extent of forming an entity, raising finance, management, audit and its dissolution. While enactments such as Companies Act and Limited Liability Partnership Act do have restrictions on the kind of activities that cannot be carried on by these vehicles (outer limit), the Acts do not regulate the actual business of the company. Thus, these statutes are not in a position to evaluate the business schemes of the entities unless they are committing fraud and

⁵⁴Entry 7: “Contracts, including partnership, agency, contracts of carriage, and other special forms of contracts, but not including contracts relating to agricultural land

⁵⁵ Moneylending and moneylenders; relief of agricultural indebtedness

⁵⁶ Act available at <https://sachet.rbi.org.in/Docs/0Ycentral%20ChitFundAct%201982.pdf>

duping the public at large. However, the fraudulent activities captured by them are limited to frauds related to accounts, audit, finance, formation, etc., i.e., limited to the aspects covered by them. Nidhi companies are within the terrain of the Ministry of Corporate Affairs.

Ministry of Finance: If any scheme primarily deals with money or any instalment that has liquidity of less than one year, it is usually captured by the money market whose regulator is the Reserve Bank of India and the overarching central government, i.e., Ministry of Finance. Along the same lines, if the transactions involve egress or ingress of foreign currency, the activities are monitored and regulated by the Reserve Bank of India.

Concerned state governments: most of the pyramid schemes are often captured by the Banning of Unregulated Deposit Schemes Act, 2019 which has pan India presence, but the enforcement mechanism is in the hands of the state governments/ governments of union territories who have to appoint competent authorities to determine and take action against unregulated deposits. This has several drawbacks which have been discussed later in this paper. The respective state governments also handle mutual benefit societies or chit funds.

Ministry of Consumer Affairs: Any business to consumer dealing is done under the regulation of the Ministry of Consumer Affairs if it pertains to a sale of product or service although the specialised nature of service/good may be under the radar of the industry-specific regulator. For instance, an insurance company providing insurance services, if found duping public by not honouring their side of the contract, the complaints can be taken up by Insurance Regulatory and Development Authority in their capacity as the industry regulator as well as before the concerned Consumer Forum (depending upon the pecuniary value of the suit) established under the aegis of the Ministry of Consumer Affairs.

Securities Exchange Board of India: Only if a company is listed/performs a function that only listed companies are ordained to do, SEBI has jurisdiction over them under Section 11 of the SEBI Act⁵⁷. Other than these general terms, Section 11A and 11AA also grant SEBI jurisdictions over particular subject matters such as mutual funds and collective investment schemes. One must take note of the exclusion carved out in Section 11AA wherein collective investment schemes do not include chit funds and Nidhi companies because the respective state governments handle chit funds (mutual benefit societies). However, there exists a strong inclination in the market that Sebi should control all money-pooling activities like Collective Investment scheme because "currently, many entities may be pooling money from the public like CIS (without a license), but SEBI cannot catch them since they work in the name of chit fund or some other name that fall under the state government's jurisdiction. Also, there have been several instances where due to multiplicity of regulators and overlap of provisions a clear action could

⁵⁷ Section 11(2A) of the SEBI Act, 1992.

not be decided and taken against illegal deposit-taking firms,"⁵⁸ there has been no shift of power as of now.

NEED FOR THE RIGHT REGULATOR

Since the recognition of the direct selling business, the Ministry of Consumer Affairs has been given the task of regulating direct selling businesses. For a long time, no steps were taken towards making direct selling businesses a safer venture for all stakeholders. It is only as late as 2016 that Direct Selling Guidelines were introduced after an intense pursuit by the industry. However, one must pause to wonder whether the Ministry of Consumer Affairs, Food and Public Distribution (and more specifically, Department of Consumer Affairs) is the appropriate branch of government to regulate and govern direct selling businesses? This doubt bothers the mind for a few reasons:

i) Direct selling is a way of doing business/trade and is no different from retail stores and e-commerce platforms, among others. If these latter modes of businesses are regulated by the Ministry of Commerce & Industry (specifically Department for Promotion of Industry and Internal Trade), there is no justification for the direct selling business to be handled by another branch of government. Even in the USA, the Federal Trade Commission, which maintains fair competition in the market (equivalent to competition Commission of India in India) and which is authorised to adopt industry-wide trade regulation and rules⁵⁹, is given the baton of direct selling business, not because consumer protection is one of its mandates. FTC handles both sides of the coin, i.e., it handles players via antitrust law (equivalent to competition law in India) and protects interests of consumers via consumer protection law. However, in India, the Ministry that handles consumer protection does not handle trade regulation for industries, nor does it handle competition issues.

ii) The mandate of the Ministry of Consumer Affairs is different from that required for the regulator of direct selling business as a form of business. This is so because a regulator needs to have a balanced approach towards a business that can help promote trade and that mode of business. However, the mandate of the Ministry of Consumer Affairs is consumer-centric, where the consumers are the nucleus. As such, the Ministry may find it challenging to create a balance between the business interests and the consumer interests when statutorily, it has been given the mandate of protecting only the interests of the consumers. For that matter, it is worth noticing that every regulator (when formed as a regulator and not a Ministry) is given an objective via statute to balance the conflicting interests of different players in the economy/industry as the case

⁵⁸ Sebi may get more powers to regulate money pooling, Anirudh Laskar & Jayshree P. Upadhyay, 13 Apr 2016, <https://www.livemint.com/Politics/vljo0AWteAaeLYsAeWovEK/Sebi-may-get-more-powers-to-regulate-money-pooling.html>

⁵⁹ Federal Trade commission, <https://www.ftc.gov/about-ftc>

may be. For example, a general regulator of the economy such as the Competition Commission of India has been given the objective to "promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India.." ⁶⁰ and the Securities Exchange Board of India entrusted with the objective "to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market.." ⁶¹ As a contrast, the Ministry of Consumer Affairs has the responsibility "to provide for the protection of the interests of consumers and for the said purpose, to establish authorities for timely and effective administration and settlement of consumers' disputes." This absence of objective to cater to the interests of the business entities/traders makes the Ministry of Consumer Affairs an inept body to regulate direct selling businesses or any other businesses as such unless such a statutory mandate is given to the Ministry. The primary objective of consumer protection is likely to cloud the interests of businesses in the absence of an express object to protect the latter's interests as a consequence of which the regulation will be not only lopsided but also inefficient. On the other hand, if the Ministry keeps the interest of the traders on the same pedestal as that of the consumers, their acts can be called in question before a court of law as well as in the parliament.

iii) As a regulator, the Ministry of Consumer Affairs is not adequately equipped to cater to the interests of direct selling businesses because the Ministry is not in a position to make trade policies that can promote or facilitate the interests of direct selling nor does it hold tools to catch hold of the fraudulent ones nor to punish the ones in violation of the law. In the absence of efficient mechanisms in place, the Ministry can neither promote direct selling effectively nor regulate it efficiently.

iv) With the focus of Ministry of Consumer Affairs is 'consumer protection', direct selling businesses, unlike its counterparts ⁶² are not able to receive due attention from the Ministry, the consequence of which is that they are far behind in attracting Foreign Direct investment ⁶³, have no dedicated trade policy, ⁶⁴ nor any significant step has been taken since their inception for

⁶⁰ Objective of the Competition Act, 2002 available at

https://www.cci.gov.in/sites/default/files/cci_pdf/competitionact2012.pdf

⁶¹ Objective of the SEBI Act, 1992, available at https://www.sebi.gov.in/legal/acts/jan-1992/securities-and-exchange-board-of-india-act-1992-as-amended-by-the-international-financial-services-centres-authority-act-2019-w-e-f-october-01-2020-_3.html

⁶² Retail business, e-commerce business, etc.

⁶³ The direct selling business is not given any separate treatment. However, that is not the case with retail trading which attracted Rs.14,161 crores in the latest financial quarter of Jan-March2020 and investment is allowed via automatic route. See for reference FDI statistics available at

https://dipp.gov.in/sites/default/files/FDI_Factsheet_March20_28May_2020.pdf

⁶⁴ Draft Ecommerce policy available at https://dipp.gov.in/sites/default/files/DraftNational_e-commerce_Policy_23February2019.pdf and regarding Draft Retail Trade Policy, see Government proposes to formulate retail trade policy: Piyush Goyal, The Economic Times, Sept 23, 2020 available at <https://economictimes.indiatimes.com/news/economy/policy/government-proposes-to-formulate-retail-trade-policy-piyush-goyal/articleshow/78278308.cms>

boosting their growth. They have become the trees of Babool that survive in the desert on their own without any support and nurturing.

The crux of the matter is that direct selling needs a proper regulator, not a Ministry to regulate its functioning. As often suggested, it is not merely about registration of the new entrants in the direct selling businesses that will weed out the foul ones. It is also about developing a robust review mechanism that can, regularly, keep a check on the ever-changing compensation plans of the direct selling businesses, product description, maximum retail prices and cost price and determinants of commission among other parameters. The growth of a well-established and soundly footed direct selling business can only be ensured not by providing fertile soil but also with the constant trimming, checks and look after the plant. After all, well begun is only half done.

An ideal regulator also requires independence and impartiality at its core. A dedicated regulator, instead of being a department of government would be an ideal match for a regulator because it remains free from the formalities of the bureaucracy and is not meant to govern but only regulate. A private agency, on the other hand, cannot be a regulator because of its affinity to funding needs and chances of being lobbied by interested parties. Its lack of accountability and transparency also becomes a cause of concern when no law binds it to do so.

Our recent experience has also taught us as to what an independent regulator is. Its ability to stand on its own when lobbying by vested interests is substantial or when the government wishes to meddle is as vital as its constitution. The regulator should consist of experts on direct selling instead of generalists, who usually lack in-depth knowledge of the direct selling businesses. The regulator of direct selling business must possess not only the intrinsic knowledge of the subject matter but also an ability to distinguish it from other businesses, especially from the fraudulent schemes that tend to dent the image of direct selling fraternity.

The regulator should also be given powers to investigate into the dubious businesses that claim to be direct selling, must have dedicated human resources to generate literature and research for all and sundry, for on-field enquiries and for keeping tabs on the regulated ones. Awareness for reporting of fraudulent schemes and for promotion of genuine DS mechanisms should also be an objective of the concerned regulator.

The regulator can gradually introduce qualifications and consistency parameters in this kind of business to elevate its standards. Courses and certification programmes that educate, train and capacitate different stakeholders of the direct selling would be ideal. This will transform the entire market to another level altogether.

THE WAY FORWARD

One cannot overemphasise the need for defining and distinguishing the terms to allow free flow of genuine businesses in the market. In order to meet the two significant challenges that face the direct selling businesses- i) fraudulent MLM operations disguised/misunderstood as direct selling businesses and ii) fraudulent practices that direct sellers of sustainable direct selling businesses indulge in, a two-pronged approach is needed - a) to enforce laws with more clarity that resonates with the business community, addressing problems and scams that plague the industry and b) the need for an on-field regulator, which is immediate and necessary. In terms of formulating a law that caters to the direct selling company, focus must be not only to define and provide tools for identifying the concepts but also to fill the gaping holes that exist in the current legal regime.

A dedicated & specialised regulator, who understands the nuances and integrities of direct selling businesses, who have in-depth knowledge of the functioning of the direct selling business as a whole and one who has the human resource to investigate into suspected businesses with the clarity of concepts and ability of comprehension of the nitty-gritty of this manner of business, is the one that is desired for a market that exists in India, which has grown tremendously and is only likely to flourish further in the coming future. The regulator should register all direct selling entities along with its promoters and key managerial personnel, no matter what business vehicle is used. This way, the regulator will have a complete database, and over a period of time, can regulate them better. The compensation plans and constitutional documents should be a prerequisite for registration on the similar lines of a company's constitutional documents and should be deemed to be public documents, accessible to the public so that they can perform due diligence if and when they wish to become a direct seller for the entities. This system can gradually transform into a registration mechanism for direct sellers too so that the direct selling companies are bound to keep proper records of their direct sellers, and it will become easier to take preventive measures to curb fraud against the public. It will also instill more accountability in the direct selling business, a trait that is more desired than ever.

A combination of strong law with proper enforcement complemented by a dedicated regulator will go a long way in putting an end to the menace of shady fly-by-night operations. In this respect, a beginning can be made by plugging the loopholes and fixing the grey areas which are open to interpretation in the guidelines/rules.

The industry has shown great potential, and it is time that the lion's real talent is tapped to increase GDP phenomenally. The industry only needs a dedicated set of laws that genuinely understand the business and a regulator that can guide the direct selling companies to their path of glory. At the same time, the policies and laws must reflect, promote and protect the interests

of all stakeholders including consumers, direct sellers, customers and society apart from the direct selling entities to develop holistically.