

June 27, 2006

To:

From: Lawrence B. Chonko, Holloway Professor of Marketing, Baylor University

Subject: Proposed FTC Business Opportunity Rule R511993

The first page and a half is stuff I sent to Misty before the DSA meeting.

I have recently become aware that the Federal Trade Commission is considering enacting changes concerning "business opportunities." I took the opportunity to read the document concerning this exhibited on your Web page and felt compelled to offer a few comments about the proposed changes as they impact direct sellers, specifically member firms of the Direct Selling Association (DSA).

As this rule is given consideration, it must be taken into account that many non-direct selling firms have embraced this method of distribution of products by purchasing direct selling firms. Some of these include: Time Warner, Reader's Digest, Sara Lee, Berkshire Hathaway, Hallmark, and Citigroup.

My first concern is with changes concerning the definition of "business opportunity." In my 25 years of association with DSA, I have witnessed how many direct selling firms present their activities. In no way are these presentations in the same genre as those of the fraudulent schemes I know the FTC is seeking to prevent, an action for which I offer my fullest support. Over the years, the DSA and its member companies have taken great steps to make certain that business opportunities are presented with full information and ethical disclosures regarding features of their business like work effort required and income opportunities.

Unlike fraudulent schemes, direct selling representatives are backed by corporate structures that engage in the same kinds of business activities that one would commonly see among Fortune 500 firms - product development, market assessment, global expansion, web site development, market research, ethics consciousness. These kinds of legitimate business activities should be sufficient to warrant some consideration for separating direct selling firms from the array of fraudulent schemes that exist in the marketplace.

A second concern arises with the "disclosure statement" requirements. Several comments are warranted here. One involves the revelation of lawsuits. While I strongly believe in and support integrity in the marketplace, the absolute requirement of disclosure assumes that the average person is capable of discerning the difference between a legitimate legal claim and those that fall into the frivolous category. What marketplace damage might occur if people make judgments on the basis of inadequate information (e.g. the existence of frivolous lawsuits) published as direct selling firms seek to comply with an FTC rule? Additionally, as direct selling companies become more successful, so does their vulnerability to lawsuits. As is common in business today, larger companies are more susceptible to frivolous lawsuits; thus, requiring companies to disclose all lawsuits may punish the more successful direct selling entities.

As an analogy, I am a college professor who has taught over 10,000 students in the past 12 years. I can tell you that there is much information about me and my class "out there." Some of it is accurate. Much of it falls into the category of "venting" by students who did not make good grades and wish to blame me for their lack of effort. When future students make decisions on the basis of poor information, they are the ones that are potentially hurt. The FRC has been a beacon for integrity of information in the marketplace. I fear that this rule runs the risk of requiring firms to place themselves in a position of providing poor information.

Concomitant with this disclosure is the requirement that direct sellers reveal cancellations for a two year period. One reason for my concern about this is that many individuals enter direct selling with short term goals in mind - to earn some money for the Christmas holidays, to earn some money for a planned vacation, etc. These individuals would all likely work for 3-4 months and then terminate their relationship.

Such statistical reporting would inflate the reported turnover in the industry, presenting a false picture of the realities of the industry. A second issue here is that other industries experience high turnover rates – trucking, restaurants – will they be subject to the same disclosure requirements? A third issue is turnover in general. In the U.S., average turnover is about 14 percent. This rate makes it mathematically possible for an entire firm to have 100 percent turnover in seven years. Put another way, a firm could, at least mathematically, find itself in a situation in which no individual has more than seven years experience with a firm. I cite these illustrations because turnover is not always the fault of the firm. People leave places of employment for many reasons, some of them positive ones. But these reasons are not revealed by statistics.

I have a third concern about the “earnings claims statements.” If this is a requirement to disclose individual earnings I am against this. If the requirement only refers to “average” earnings, direct sellers would be in a constant state of updating the average. Further, the proposed rule requires direct sellers to provide “characteristics” about those who earn certain amounts. This places an unfair burden on direct sellers and direct selling companies to update and store information. Further, the sum total of academic research has been unable to answer the question, “What makes a successful salesperson?” At best, we have some correlations and much anecdotal evidence. The spirit of the intent to provide potential direct sellers with full information is admirable, but the letter of the intent is unattainable.

A second reason I am concerned about the disclosure of earnings is simply for privacy reasons. A second is that too many people look selectively at such numbers and convince themselves that they can be at the top of the earnings list. When people enter a business of any kind, they do so with the intention of making it a profitable venture. My concern is that they are often very good at dreaming and projecting income streams that may be realistic but are certainly also ambitious. These same people also struggle with their assessment of the costs of starting a business – time, energy, work, dollars. Very often they are also less than objective about the realities of what it takes to start a business, underestimating those costs. That is my experience with many who wish to start a traditional small business, ones that have nothing to do with direct selling. My concern is that the FTC’s intent is to inject a dose of reality into decision making and, again, I wholeheartedly support such endeavors. As an analogy the Small Business Administration provides a wealth of information to potential small business entrepreneurs and much of this information is ignored by many. Will the new FTC rule be ignored by those seeking fraudulent gain? Will the new FTC rule undermine the efforts of legitimate direct sellers who, as of now, appear to be placed in the same category as these fraudulent schemes?

A fourth area of concern is the proposed seven day waiting period. Over seven days, the enthusiasm of any sales/decision moment is lost. The direct sellers have long embraced a principle of little or no financial risk to those who decide to enroll with one of the member companies. All DSA members must have a buyback provision so that those who enroll can quit without question and with a minimum of 90 percent of their small investment refunded without question. Because of this provision, the proposed new rule, in my judgment, unfairly equates direct sellers with those who would proffer fraudulent schemes with no such buy back guarantees.

There are other potential impacts of the proposed new rule that I trust will be given serious consideration. We live in a society that has promoted and applauded women in business for decades. Most of those individuals entering into direct selling are women. Their entrepreneurial spirit is second to no other group. Their dedication to providing value to customers is laudable. Millions of women have improved their lifestyles and standards of living by being associated with direct selling in whatever capacity they chose – as CEOs of companies or as a stay-at-home mom who enrolls with a company for a short time period to earn Christmas money for the children. The extent that the proposed new business opportunity rule impacts direct selling, the effects on business opportunities for women might be dramatic.

Similarly, as a professor, I have had the opportunity to visit with many students about direct selling opportunities. A few of these students have pursued careers in the industry. Most of these students are looking for either summer or part-time employment to help defray the costs of higher education. As the costs of college education escalate, direct selling offers a legitimate opportunity for students to learn about business and earn much needed college money as a mean of paying for their education and reducing their future debt.

One must also look at the impact on the entire value chain associated with direct selling companies. Direct selling companies deal with many supplier companies. These companies supply products and services to direct selling companies and employ many thousands of people. There may be a significant negative multiplier effect on product choice and on jobs if direct selling companies' presence in the marketplace is hindered by the proposed new rule.

There are also several practical questions I would pose: 1) Is it possible for any direct selling independent contractor to identify the 10 "nearest" representatives? 2) Is it possible for anyone to report all litigation? 3) Is it possible for any one to report accurate actual earnings other than their own? Placing these kinds of reporting burdens on 13 million independent contractors will result in creation of millions of pages of data. The result can only be extraordinary administrative costs that those purveyors of fraudulent schemes are not likely to incur as they will ignore the provisions of the proposed business opportunity rule as they have ignored past provisions.

Let me conclude by saying that the FTC has a partner in the DSA. DSA has a rich tradition of kindling an entrepreneurial spirit among many. The DSA is also strong in its support for ethical business behavior. The entrepreneurial spirit manifest in people entering a legitimate business endeavor, initiating ideas, thinking through problems, and seizing legitimate business opportunities is something that must not be quenched. Surely, care must be taken to minimize, ideally eliminate, those who would take unfair advantage of others. The direct selling industry is not of this ilk, but I fear that they may suffer unneeded side effects as a result of the good-faith intentions of the new FTC rule.

I reiterate my affirmation of the FTC's efforts to eliminate business fraud. In the case of the new business opportunity rule, my concerns are not rooted in the spirit of the rule. Rather, they are rooted in the many issues cited above as well as the practicality of the rule. The benefits of exposing fraudulent schemes must be weighed against the costs that will incur as a result of the direct selling industry being impacted by this new rule.