

## **Regulating dubious direct selling businesses under the consumer protection act, 2019**

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### **1. Introduction**

The twenty-eighth of December, 2021 was a much celebrated day amongst various stakeholders of the direct selling industry across the nation when consumer protection (direct selling) rules, 2021 was notified to govern the provisions of consumer protection act, 2019. Being the sole legislation in the regulation and monitoring of direct selling businesses, the Consumer Protection Act, 2019 serves as the necessary impetus paving the way for rules specific to direct selling and e-commerce. The long-term sustainability of any business firm lies in the maintaining long-lasting relationships with its consumers such that the interest of the consumers is protected. Legislation plays a vital role in instilling consumer confidence and trust. The transformation of direct selling legislation from caveat emptor (let the buyer beware) to caveat venditor (let the seller beware) was through a series of legislations with respect to direct selling. This article strives to draw the reader's attention to the previous regulatory framework for governing direct selling activities in the state of Kerala, to find out how the new rule demarcates itself from the previous legislation and the possible impact of the new legislation in the business of direct selling.

Direct selling has received much resentment from the general public, not only in the domestic market but also in the foreign markets. Direct selling, is a form of selling the product or the services directly to the potential consumer away from a fixed retail location (Peterson and Wotruba, 1996) which was in common prevalence prior to the industrial revolution. That coupled with a higher degree of specialization led to the growth of the wholesaler and retailers. Over time the producer and potential consumers felt the need to interact directly

bypassing the middlemen, in order to reap the benefits of product cost and profit benefits for both the end parties of the exchange. This had led to the concept of a directly selling to the consumer.

The distinction that is visible in today's direct selling is in the way of the organization (Chu and Segre 2010). Direct selling, practiced by the direct selling organization unlike the itinerant traders is an organized form of trade, is defined through a strict organizational hierarchy and authority. Direct selling functions as single-level marketing as well as multi-level marketing or network marketing. The literature provided by various direct selling entities claims it as not only selling a product or service to the consumers but also providing an income-generating opportunity. It is this aspect of "income-generating opportunity" that often raises questions regarding its legitimacy and ethicality.

Pyramid scheme, Ponzi scheme, money circulation scheme etc., are often used in tandem when referring to multi-level marketing. The major difference lies in the way the commission is earned by the direct sellers. Multi-level marketing enterprises provides commission on the sale of the product or services directly to the consumers, namely the retail profit, and also a percentage of profit based on the sale of their downline to their consumers. However, some dubious schemes earn commission on the basis of adding new members to the network, without providing any basis for the existence of a sound product or a service. The existence of a product or a service to sell, having no or minimal entry charges, no overloading of distributors with inventory, and provision for the buyback of unsold inventory are the key factors differentiating illegal scheme to genuine direct selling firms (Albaum and Peterson 2011).

Direct selling has gained relevance as providing an income-earning opportunity with no capital investment or stock requirement that ensures greater flexibility and a source of supplementary income. The built-in training and motivational orientation equip the direct sellers to help in developing a skilled workforce. Mukherjee et al.(2010) state that financial independence, higher earnings, development of personal and business skills, flexible timings, and improved ability to take care of families were some of the benefits of direct selling. They also state direct sellers benefitted to build their self-esteem, confidence, and better sales skills thereby the number of direct sellers' have increased with a substantial increase in their incomes and the direct sellers were happy with the quality of their employment. Moreover,

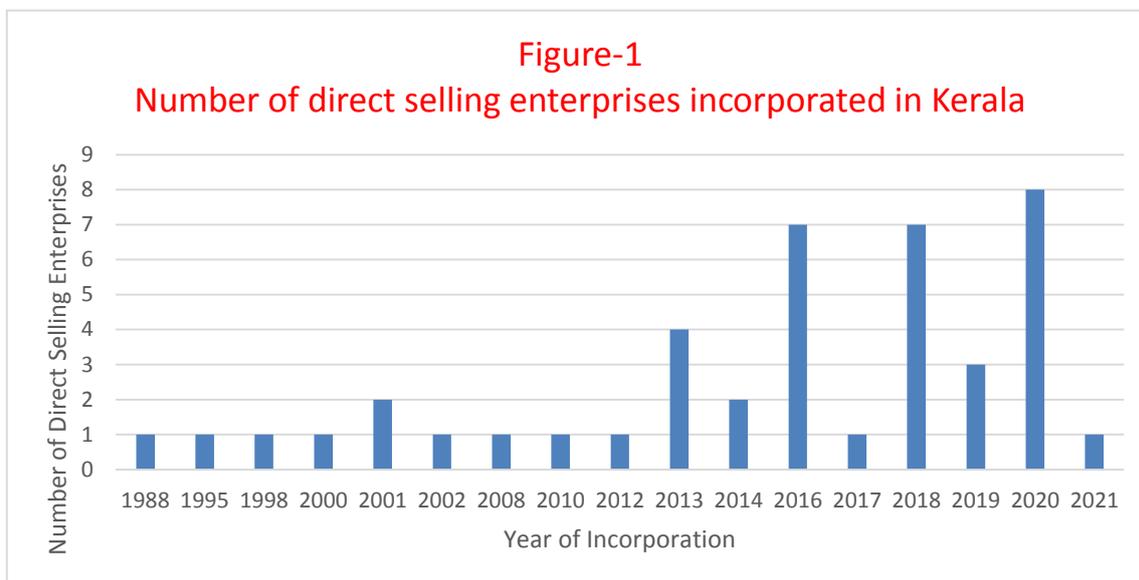
the study also states that women were empowered by being financially independent and have substantially increased their ability to save.

This paper is divided into the following sections such as direct selling prior to consumer protection act, 2019, thirdly, the new ‘consumer protection (direct selling) rules, 2021’, fourthly, the distinction of the new legislation to the previous legislation, fifthly, implication of the new consumer protection (direct selling) rules,2021 on the business of direct selling, followed by conclusions

## **2. Direct selling prior to Consumer Protection Act, 2019**

Genuine direct selling enterprises often faced difficulties in operating in a hostile environment wherein multi-level marketing entities were considered identical to their illegal counterparts. Prior to the enactment of the consumer protection act, 2019, direct selling was mainly governed by prize chits money circulation scheme (PCMCS) (banning) act 1978, Kerala VAT act, 2003 in Kerala, and the direct selling guidelines 2016 at the central level (hereinafter referred to as central guidelines). PCMCS (banning) act, 1978, had considered all direct selling enterprises as a money circulation scheme, with no clear-cut distinction between the legitimate direct selling and the illegal counterparts. The absence of strong legislation led to widespread arrest, penalties, imbibing a negative image even for genuine enterprises. Kerala VAT act, 2003, was the first legislation in the country wherein separate provision had been enacted for the registration of direct selling enterprises as a separate legal entity to facilitate their businesses, which eventually paved the way for the formulation of guidelines at the central level. Subsequently, the central guideline, 2016 was another major step undertaken by the government giving the necessary impetus to foster the growth of genuine direct selling enterprises in the country. The 2016 guideline was in advisory nature to the state government that specifies the obligation of direct sellers and direct selling entities. As per clause 9 of the central guidelines, every state government had to formulate a monitoring mechanism and in compliance with this direction, Kerala government was the first state by notifying a State level monitoring mechanism as per GO (P) No. 8/2018/CAD dated 4<sup>th</sup> June 2018. Subsequent to this, more than fifteen states had formulated their State level mechanism in line with the Kerala’s guidelines as their state-level monitoring mechanism. However, the recent legislation provided the much-needed legal cushion for the

direct selling enterprises in the country and, the central guidelines, 2016 had been withdrawn by the Consumer Affairs Department, Government of India vide Notification No GSR 37(E) dated 21<sup>st</sup> January 2022.



*Source: Compiled from the Department of Consumer Affairs, Government of Kerala*

The above figure illustrates that the number of direct selling enterprises incorporated in a year had been rampant subsequent to the Kerala finance act, 2015<sup>1</sup> and central guidelines, 2016. The onset of the pandemic further facilitated the growth of direct selling ventures, through the virtual world as is illustrated by the highest spike for the year 2020. This clearly illustrates that as the regulatory framework strengthens in the state, business confidence improves setting the foundation for genuine direct selling venture in the state.

### **3. The new ‘Consumer protection (direct selling) rules, 2021’**

The consumer protection act was enacted in 1986 which was subsequently amended in 2019 with more focus on consumer protection. As part of this amendment, new provisions were incorporated to regulate direct-selling, multi-level marketing, telemarketing, e-commerce. The ministry of consumer affairs, food, and public distribution notified the consumer protection (direct selling) rules, 2021 in accordance with Clause (zg) of Sub-Section (2) of

<sup>1</sup> Sec 8 (i) was inserted through Kerala Finance Act 2015 w.e.f. 1.4.2015

Section 101 read with Section 94 of the consumer protection act, 2019. The rules state that the entities shall comply with the provision of the rules within ninety days from the date of the publication of these rules in the official gazette.

The rules provide clear-cut definition of the terms used in common direct selling terminology namely, cooling-off period, direct seller, direct selling entity, money circulation scheme, mis-selling, prospect, pyramid scheme, saleable, sensitive personal data, state. The rule doesn't make a distinction between the various formats of direct selling, and uses only a comprehensive term, encompassing "all models of direct selling" under 2(b). However, the consumer protection act provides for the definition of direct selling under sec.2(13) as, "marketing, distribution, and sale of goods or provision of services through a network of sellers, other than through a permanent retail location". The rule explicitly mentions a pyramid scheme, as a venture devoted to enrolling members to the team such that it involves a hierarchical structure.

Direct selling entities are required to make full disclosure of memorandum, articles of association, permanent account number, tax deduction, and collection account number, goods and services tax registration, returns, audit report, trademark certificate balance sheet, register of direct sellers, license certificate and such other certificates, that are required by the government from time to time.

Though the earlier guidelines have mentioned the income-generating opportunity of direct selling enterprises as a remuneration plan, the new enactment does not explicitly mention the remuneration or compensation but it mentions that any amount of commission, bonuses, or any other incentives should be of the products or services of which the company owns a distinct trademark, service mark, or any other identification mark. Such a categorization is distinct from the earlier enactments, as it provides a vital basis for classification for the genuine direct selling enterprises from the fake enterprises. Section 5(e) of the consumer protection (direct selling) rules, 2021, signifies the relevance of a valid product or service based on which sale can be initiated, and demolishes the ambiguity surrounding the operation of direct selling entities.

The rule also lays down the terms of its relation with direct sellers. The basis of every relation between a direct selling entity and a direct seller is through a written contract that authorizes the direct selling entity to sell or offer to sell on behalf of the direct selling company. This

also makes the direct selling entities accountable to handle the complaints, grievances arising out of the goods and services sold through direct sellers.

The entities are required to maintain a well-updated website furnishing with all relevant information with respect to the name of the entity, addresses, branches, contact information, ticket number for lodging of complaints, information on the return, exchange, necessary warranty and guarantee details, delivery mechanism, modes of payment and grievance redressal mechanism. The entities are also required to maintain a list of those direct sellers who have been delisted from company records and publish them on the website, for the information of the general public.

The rule mandates the acknowledgment of the complaint should be done within 48 hours of lodging of the complaint, and the company should redress the issue within two months.

Apart from the obligation on the part of the direct selling entity, direct sellers are also obliged as per written contract, to disclose identity at the time of sale, disclose all relevant information at the order form, obtain relevant documents with regard to GST, PAN, and they should not request the consumers to purchase literature, and they are entitled not to use direct selling as a form of market research.

#### 4. Demarcation of the Consumer Protection act, 2019 to the previous legislations

Table 1

<b>Points of difference</b>	<b>Direct selling guidelines 2016</b>	<b>Consumer protection (direct selling) rules 2021</b>
<b>Legal Enforceability &amp; Reliefs</b>	Advisory in nature – Civil remedy only for breach of contract	Legally enforceable through consumer courts for reliefs including product compensation.
<b>Registration of direct selling entities</b>	Mandatory to register in the online portal maintained by the Consumer Affairs Department(CAD)	No registration before the CAD or the DPIIT. Only self-declaration by the entity and certification by a qualified cost accountant
<b>Remuneration plan and income /commission distribution</b>	Explains the modalities of payment of remunerations	Remuneration is limited to goods and services sold or supplied with distinct identification mark.
<b>Involvement of department other than CAD</b>	Functioning under the CAD with separate monitoring mechanism	In addition to CAD, involvement of department of legal metrology and Food safety department are incorporated in the rules

<b>Direct selling &amp; Ecommerce</b>	No provision for e-commerce	Separate rules for direct selling (DS rules,2021) and E-COMMERCE (e-Commerce Rules, 2020) were notified
<b>GST registration</b>	Provision for registration is stipulated only if the turnover crosses the threshold limit	All direct sellers and direct selling entities are required to obtain a GST registration, irrespective of threshold limit.
<b>Dispute settlement</b>	Provision for redressal mechanism is mandated	Apart from consumer redressal & nodal officers, specific provisions for product liability and penalty are also incorporated in the rules for the protection of consumers
<b>Regulator</b>	State government to set up monitoring and regulatory authority to regulate activities of direct selling	The rules provide for the setting up of a monitoring and regulatory authority at the state level. The Act also provides for a central & regional consumer protection authority to regulate this sector.
<b>Provision for approaching consumer courts</b>	No provision to consumers to approach consumer courts	Since direct selling & network of direct sellers are included in the CP Act, the consumers under direct selling & MLM are entitled to approach consumer courts
<b>Provision for mediation for the settlement</b>	No provision for mediation. Guideline provide for the execution of the contract with direct sellers.	Consumer Court can refer the cases for settlement through mediation process

*Source: Prepared by the Authors based on Direct Selling guidelines 2016 and Consumer protection (direct selling) rules 2021*

A series of deliberate attempts had taken place in order to fulfil the motive of regulating direct selling businesses. As compared to the direct selling guideline, 2016, the new consumer protection (direct selling) rules 2021 is legally enforceable. The proposal in draft consumer protection rules, 2021 had necessitated the registration of direct selling entities and direct sellers at the department of promotion of industries and internal trade, whereas the new consumer protection (direct selling) rules, 2021, haven't provided for the registration before the department of consumer affairs nor the department of promotion of industries and internal trade. The state has been given the autonomy to regulate and monitor the activities of the direct selling enterprise. All direct sellers and direct selling entities are required to obtain a GST registration whereas the guideline had only provided for registration, after it crosses a

threshold limit. Table 1 illustrate the differentiation of central guideline, 2016, and new consumer protection (direct selling) rules, 2021.

### **5. Implication of the new consumer protection (direct selling) rules,2021 on the business of direct selling**

The enactment provides a strong impetus for the growth of the business of direct selling. The repealing of the guideline makes it clear that the ambiguity surrounding direct selling ventures is being removed.

The direct selling rules under the consumer protection act, 2019 have mentioned that any bonuses, incentives and commission to be received from the sale of the products should carry the necessary identification mark by the company to do so. This may provide the base to differentiate genuine direct selling companies from fake ones. However, the intricate remuneration plan like the binary plan, uni-level plan, hybrid plan could have been regularised such that an ideal remuneration plan has lesser negative implications on the direct sellers and its consumers.

The rules have explicitly mentioned that transparency should be maintained in communicating prices to the final consumers including the break-up of all the prices. However, direct selling is essentially selling the products directly to consumers by bypassing the middlemen, wholesalers, and retailers, such that the end parties are benefitted. But in usual practise, the products are often heavily priced and no mechanism has been brought in to regulate the prices such that it benefits the consumers.

### **6. Conclusion**

The retail sector is an ever-evolving phenomenon, wherein newer formats of trade take place with the changes in consumer behaviour, information technology, changes in the foreign investment policy, and legal environment. The era of information technology has facilitated greater transparency, thereby rendering increased accountability and ensuring consumer protection as a key to every business enterprise. The enactment has therefore ensured that India has transformed itself from caveat emptor to caveat venditor in the business of direct selling through a series of legislation.

The enactment of the consumer protection act, of 2019 and the rules framed under (i) consumer protection (direct selling) rules 2021 and (ii) the consumer protection (e-commerce) rules 2020 had widened the scope of trade encompassing newer formats namely, e-commerce and direct selling of all formats. This served much clarity in the subsequent regulation and ensured greater protection of the consumers doing trade through these platforms by ensuring product quality, product warranty, product refund, product liability.

The enunciation of regularization of direct selling operation by the government of India has in one way catered to the demand of the direct selling community at large by ensuring a separate legal status. The convergence of physical and digital space has transcended traditional boundaries of exchanges, paving way for newer formats to evolve. the dynamic nature of trade requisites timely and efficient monitoring of the direct selling operation in the state of Kerala. Hence, the requirement for setting up of a compliance mechanism can help in fostering the growth of genuine direct selling ventures and inhibit the illegal counterparts.

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