

Deloitte Access Economics

Social and economic impacts of direct selling

Direct Selling Association
of New Zealand

November 2013

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Glossary

| | |
|-------|---|
| CGE | computable general equilibrium |
| DAE | Deloitte Access Economics |
| DSANZ | Direct Selling Association of New Zealand |
| DSO | Direct Selling Organisation |
| FTE | full-time equivalent |
| GDP | gross domestic product |
| GNI | gross national income |
| ISP | Independent Sales Person |
| MLM | Multi-level marketing |
| WFDSA | World Federation of Direct Selling Associations |

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Executive Summary

The Direct Selling Association of New Zealand commissioned Deloitte Access Economics to undertake an analysis of the social and economic dimensions of the direct selling industry. The aim of this report is to gather information about the nature, characteristics and performance of the direct selling industry in New Zealand. The purpose of this is threefold:

- to inform DSANZ internal discussion and future planning;
- as a basis for discussion with government – to make informed representations to regulators and all levels of government – the public, customers and the media; and
- the project will also give DSANZ members valuable data for benchmarking their performance.

The retail industry in New Zealand encompasses a diverse range of businesses from online sole traders to large nation-wide department stores. Within this broad industry, direct selling is a distinct channel through which consumers purchase retail goods. Competition is driving change in the industry, the result of the rise of online retail activity and increased competition from foreign companies selling into New Zealand.

Due to the lack of information on direct selling available, the DSANZ commissioned two surveys to help improve understanding of the industry. One survey was of DSANZ member direct selling organisations (DSOs), while the second survey was of the independent sales people (ISPs) that sell the products. Customers not affiliated with the industry were not directly surveyed, although some information on customers was obtained from the other surveys.

The nature of the direct selling business

Direct selling is an alternative pathway through which consumers and sellers interact, while participating in the same activities as the broader retail industry; i.e. providing consumers with goods and services. The characteristics of direct selling which make it a separate and distinct aspect of the retail environment include:

- being primarily based on ISP-customer relationships, rather than one-off interactions;
- taking place away from traditional ‘bricks and mortar’ retail premises;
- involving sales people to train and manage a team of sales people beneath them (downlines) – in this sense ISPs are also small business owners; and
- utilising ISPs for a range of activities which are not typically associated with retail sales people, including being responsible for marketing and product promotion.

The measurement of DSANZ member activity in this study will be indicative, but not definitive, of the channel’s presence in New Zealand. The information described in the economic contribution is based only on DSANZ members and ISPs affiliated with those members. This does not take into account any other firms or individuals operating in New Zealand and who are not members of the DSANZ. The size and scope of the direct selling industry in New Zealand is greater than the estimated dimensions presented in this report, this is a conservative estimate of the broader direct selling industry in New Zealand.

The social contribution of direct selling

There is an important social element to the direct selling industry. Based on ISP-customer relationships, the industry allows disengaged people to re-enter the workforce in a way that is highly flexible, and also provides opportunities to develop confidence and business skills.

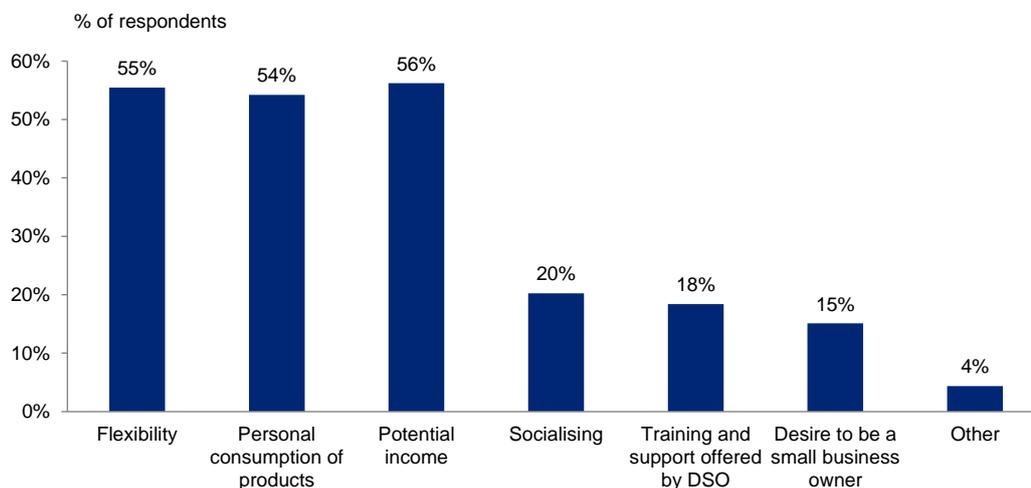
The salesforce

The direct selling salesforce is predominantly female, although males are more in evidence in areas where there are opportunities to build their own business. The largest age group is between 36 and 55 years, although all age groups are represented. While most ISPs reside within metropolitan regions, there are ISPs working across New Zealand.

Motivation, satisfaction and benefits for entering direct selling

There is a range of motivations for ISPs involvement in the direct selling industry, with flexibility and potential income to the fore (Chart i). Indeed, the ability to set your own hours as an independent ISP and the social aspects of direct selling through developing and maintaining relationships with customers sets the direct selling industry apart from the broader retail environment. The ability to purchase products (often at wholesale prices) for their own consumption was also important.

Chart i: Motivation for involvement in industry



Source: Deloitte Access Economics, ISP survey. Note: respondents were able to select more than one response.

Almost half of the ISPs surveyed cited improved self-confidence and the opportunity to improve both life and business skills were important benefits of working in direct selling. ISPs involved in direct selling were broadly satisfied with the industry:

- 36% of respondents rating their satisfaction with remuneration seven out of 10 or higher, suggesting that income is meeting expectations;
- 49% rated their overall satisfaction with direct selling as seven out of 10 or higher.

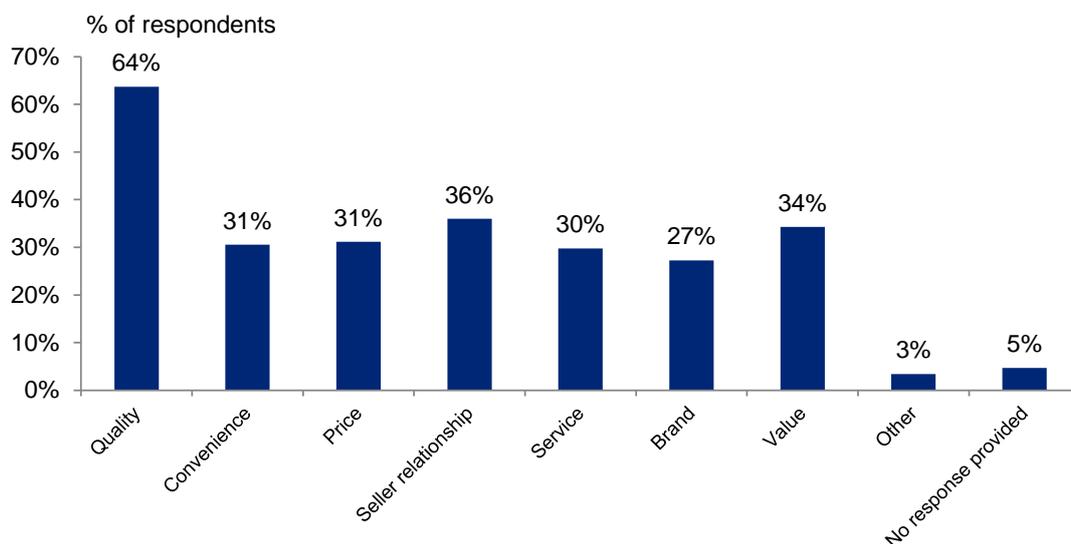
Turnover

There are perceptions that the direct selling industry has high turnover. The survey results show that around 54% of ISPs had been involved in the industry for more than three years – and around one quarter of ISPs had been involved in the industry for less than one year. This is higher than the average turnover rate across all industries of 15.9% per annum in New Zealand, as estimated by Statistics New Zealand in June 2012.

The customers

The age profile of ISPs is closely replicated in their customers, as family and friends are key markets for ISPs to sell into, especially for party plan models.

Chart ii: Why ISPs believe their customers purchase their products



Source: Deloitte Access Economics, ISP survey. Note: respondents were able to select more than one response.

Many (64%) ISPs thought that the availability of quality products was a reason that retail customers purchased goods through the direct selling channel. The convenience of direct selling and competitive prices were also cited as important motivating factors.

Almost all (83%) ISPs surveyed said that they had not received a complaint in the last 12 months. Of those ISPs who stated that they had received at least one complaint in the last 12 months 48% cited the quality of the products as the main reason.¹

Economic contribution of the direct selling industry

The direct selling industry makes an important economic contribution to New Zealand. Direct selling is an alternative to traditional ‘bricks and mortar’ retail, and as such the industry encourages workforce participation, competition, innovation and choice.

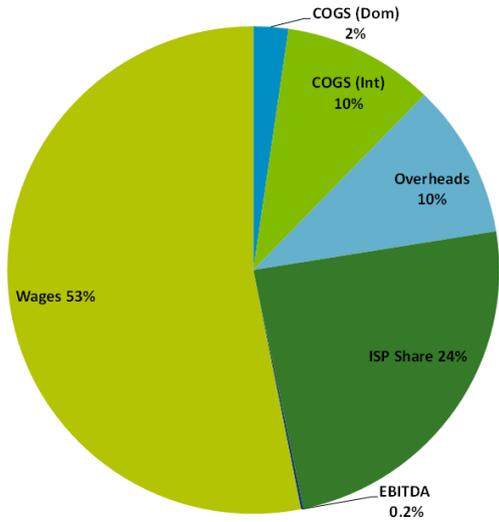
¹ Members of the DSANZ are required to provide a full money back guarantee of 10 days for goods sold, most DSOs provide periods of between 30 and 60 days on consumer goods.

Direct selling is a flexible means for those who may otherwise be disengaged with employment to enter the workforce. In this way the direct selling industry increases workforce participation and boosts productivity. The direct selling industry also provides additional income to individuals earning low incomes.

The economic contribution of the direct selling industry can be measured directly through revenue earned by the ISPs and wages paid to employees directly employed by DSOs. In addition to this are the profits made by the DSOs and the taxation revenue that is received by governments. The impact of the direct selling industry on the New Zealand economy is broader than what is captured by the Gross Domestic Product and employment estimates alone. In particular, the direct selling industry encourages greater flexibility of the workforce, productivity improvements and increased labour supply, which provides additional benefits to the New Zealand economy.

DSANZ members' revenue in 2012 is estimated to be more than \$96 million. More than half of this revenue is paid as wages to workers employed directly by the DSOs, and around one quarter of this revenue is paid to ISPs.

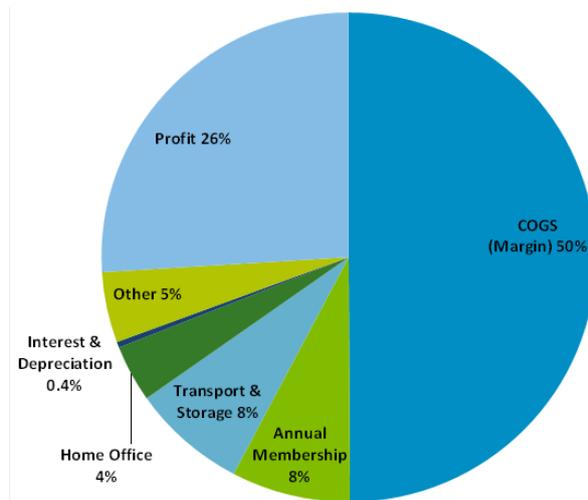
Chart iii: Average DSO revenue, 2012



Source: Deloitte Access Economics calculations

The revenue of ISPs in 2012 is estimated to be almost \$253 million. ISPs retain roughly one quarter of revenue and outlay around half on cost of goods sold.

Chart iv: Total Revenue split for the average ISP, 2012



Source: Deloitte Access Economics calculations

There is also an indirect economic contribution, which captures flow on effects from the direct selling industry to associated industries (such as the Transport support services and Storage support service industry, the Auxiliary finance and insurance services sector and Manufacturing) which supply goods and services to the direct selling industry. In this respect, the additional employment generated, and addition to gross output, is similar to other retail models.

The key elements of the economic contribution of direct selling are presented below.

Table ii: Economic contribution of the direct selling industry

| | |
|-------------------------------------|-------|
| <i>Direct value added</i> | |
| Direct value added (\$ million) | 170 |
| Direct employment (FTE) | 4,262 |
| <i>Indirect contribution</i> | |
| Value added (\$ million) | 56 |
| Employment (FTE) | 380 |
| <i>Total contribution</i> | |
| Value Added (\$ million) | 226 |
| Employment (FTE) | 4,642 |

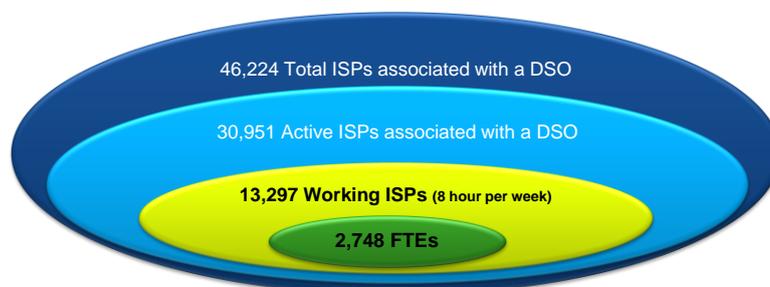
Source: Deloitte Access Economics calculations

Direct selling is comparable in size to fuel retailing (\$172 million value added and 5,757 employed), radio broadcasting (\$173 million, 2,498) and electrical services (\$371 million, 4,309).

At the end of 2012, the DSO surveys suggest there were over 46,000 ISPs associated with a DSO, of which 31,000 were active. However, many of these active ISPs purchase the goods for their own consumption and don't work any hours during the week. There are effectively

2,748 FTE ISPs that work 37.5 hours a week. Using the 8 hour per week survey average, there are over 13,000 ISPs working.²

Chart v: ISPs in the New Zealand Direct Selling Industry, 2012



Source: Deloitte Access Economics calculations

Challenges for the industry

Public perceptions

There are some negative reactions to the industry and persistence of negative stereotypes in the media and general public. In particular, there is a belief that if there is a multi-level structure for remuneration, which is widely used throughout the industry, this is akin to a pyramid scheme and that the industry is involved in high pressure selling. These negative public perceptions continue to concern those involved in the direct selling industry.

- Perceptions of direct selling being linked to pyramid selling were noted in both consultations and the survey as an ongoing concern for the industry. However, evidence suggests these perceptions are misplaced.
 - A majority (73%) of ISPs do not manage a downline, a prerequisite for pyramid selling.
 - Over half of ISPs purchased goods for their own use – not to on sell to other consumers.
- Further, the key consideration for pyramid selling is a scheme where the principle purpose of the scheme is reward for recruiting irrespective of whether a product is sold. The multi-level reward system is widely utilised throughout the industry. The distinguishing feature of this is that these businesses have the principle purpose of the sale of goods or services and where, if no recruitment occurred, reward for the sale of goods and services would continue.
 - ISPs report that most complaints that are received relate to the quality of the product and delivery times, rather than aspects of the transaction between ISP and consumer.
 - Historical complaints data issued by the Ministry for Consumer Affairs in 1997 showed that around 50,000 consumer complaints about general retail were received on their hot line, while direct selling had 14 in a given year. This indicates that the level of complaints for Direct Sales is very low

² Active ISPs are defined as ISPs who made a sale in the last 3 months, and the working ISPs figure uses the average working ISP's weekly hours (7.75 hours) and applies the appropriate ratio to find the amount of working ISPs per FTE.

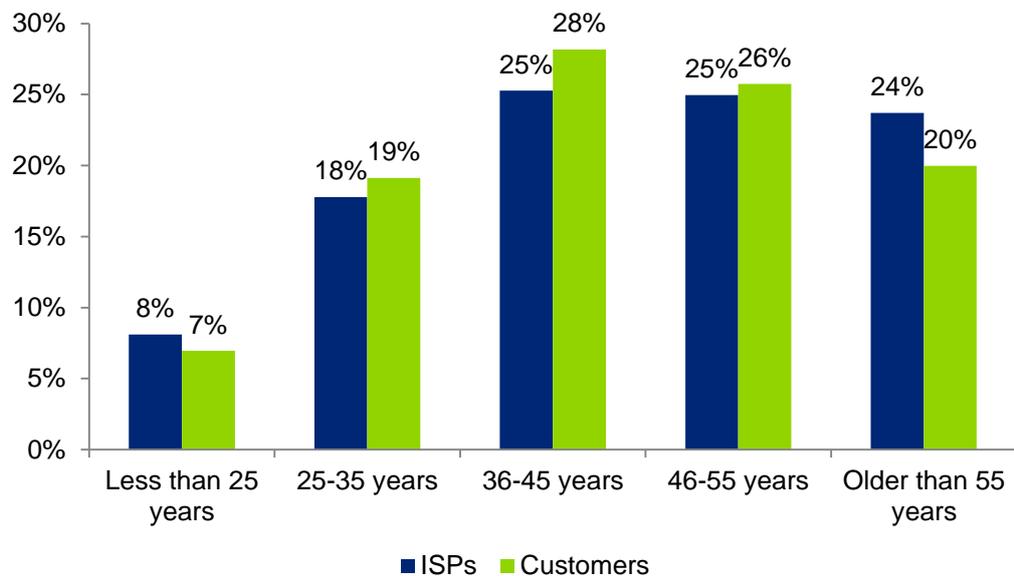
compared to retail. Statistics to make more recent comparisons are unavailable.

- A search of state and commonwealth government websites failed to turn up any official data on the number of complaints by customers against direct selling retailers or comparisons between direct selling and other industries.

Demographic change

New Zealand is undergoing a demographic shift. While the direct selling industry is often associated with older generations and seen to be not attractive to younger cohorts, in particular Gen Y's, this is not an accurate reflection of the industry. The younger generations of ISPs already in the industry – and the customers they sell to – will become more important as New Zealand's ageing population moves towards retirement.

Chart vi: Comparison of age



Source: Deloitte Access Economics, ISP survey.

Further, the structure of payments in the industry means that ISPs are able to continue to earn income after they have retired from the workforce. This is a key differentiating feature of the direct selling industry

Online retail

Like demographic change, online retail presents a significant opportunity for the industry. It will be necessary that the industry proactively adapt to the changes that the rise of online retail has already and will continue to bring. A range of digital applications are available which support and complement face-to-face selling with online ordering and payment facilities.

The focus on face-to-face relationship selling, a key tenet of the direct selling industry, will be tested by the move towards more online interactions. It will be the ability to adapt to technological change which will be important to direct selling remaining a viable retail alternative.

Conclusion

The direct selling industry is a distinct part of the New Zealand retail environment that makes a significant social and economic contribution to the country. A lack of understanding of direct selling – stemming from a dearth of information about the DSOs, ISPs and their customers – is making it difficult for the industry to show that negative perceptions are unwarranted.

At the same time, the industry needs to better understand itself, to deal with issues such as demographic change and technological advances that will be important for its future growth.

This report marks the beginning of assembling a database which will help the industry to deal with some of these issues. Over time, it will be important for the coverage to be extended to include more DSOs and ISPs and directly to survey their customers, including DSOs not affiliated with the DSANZ. Ideally, official statistical agencies would collate and publish accurate information on the dimensions and nature of direct selling to better inform the public and policy makers about the industry. Until then, there are outstanding questions that this report has not addressed; instead this report has provided the starting point for a better understanding of direct selling in New Zealand.

Deloitte Access Economics

1 Background

In New Zealand, direct selling organisations (DSO) are represented by the Direct Selling Association of New Zealand (DSANZ). DSANZ wants to develop an evidence base to support their endeavours on behalf of the industry. The lack of information about the social and economic contribution of direct selling reduces the industry's visibility to policy makers, the public and the media and diminishes the power of its arguments. This unfavourable situation also exists internationally.

1.1 What is direct selling?

The retail industry in New Zealand encompasses a diverse range of businesses, from online sole traders to large nation-wide department stores. Within this broad industry, direct selling is a distinct channel through which consumers purchase retail goods. The sector has recently been undergoing a period of adjustment, the result of the rise of online retail activity and increased competition from foreign companies selling into New Zealand.

There is inadequate measurement and understanding of the social and economic contribution of the direct selling industry. This unfavourable situation exists both nationally and internationally. Currently, Statistics New Zealand does not include direct selling activities as a separate component of the retail trade publication. It is included in the *Non-store and commission-based retailing* along with internet retailing, mobile food retailing (expect takeaway food) and milk vending.³

1.1.1 Defining direct selling

The definition of what constitutes 'direct selling' and how it can be differentiated from other retail channels is important for assessing the economic and social dimensions of the industry. The boundaries around direct selling need to be clear, to maximise the accuracy and consistency of data gathering and empirical analyses, but also robust enough to accommodate potential changes to direct selling in the future, e.g. due to technological innovation.

Early direct sellers were the original retailers, hawkers and pedlars selling goods door to door and with neighbouring communities. Indeed in some respects, direct selling has not changed since the days of the travelling salesman of old, as DSOs enjoyed relatively stronger sales in country areas, which reflects limited choice for consumers and the social aspect of party plans magnified by the greater distances between friends and family. Similarly, the characteristics which defined early direct selling, such as the close relationships between sellers and buyers continue to characterise the direct selling industry today.

³ This class consists of units mainly engaged in retailing goods without the use of a shopfront or physical store presence, including milk vendors, sole e-commerce retailers and direct shopping units.

More recently direct selling has been recognised as non-store physical selling through doorstep, network marketing and party plan methods. These methods, particularly network marketing and party plan are increasingly integrated, and direct selling business models invariably have elements of remote selling.

Increasingly technology and social media are playing a role in alternative methods for the distribution of goods and services. Today direct selling encompasses direct consumer contact that is face-to-face, via the telephone or over the internet.

The following definition of the direct selling industry was used throughout this project.

Direct selling is a channel of *distribution* of goods and services directly to the *consumer* (World Federation of Direct Selling, 2012), primarily through personal (seller to buyer) contact away from permanent retail locations, generally in a home, a workplace, or another neutral location (Peterson and Wortuba, 1996).

Other key definitions used are for the organisations, or firms, that provide the goods – the **direct selling organisations** and the consultants or distributors who sell the goods – the **independent sales people** (ISPs). A list of DSOs is provided in Appendix C.

Accurately describing the nature, characteristics and performance of New Zealand direct selling requires definition and measurement. This is challenging because DSANZ does not represent the whole of New Zealand’s direct selling industry, with other small and large operators using direct selling competing with DSANZ members.

There are also retailers that have a direct selling presence that would not be quantifiable from financial reports. For example, there are companies that complement their traditional ‘bricks and mortar’ distribution of products with doorstep selling models. Many other retailers and service providers may use personal contact with customers and experience selling as part of their marketing and customer contact techniques, for example energy retailers or telecommunications companies.

It is difficult to establish the true penetration of these methods. Hence, the measurement of DSANZ member activity in this study will be indicative, but not definitive, of the channel’s presence in New Zealand. That is, the size and scope of the direct selling industry in New Zealand is greater than the estimated dimensions presented in this report.

1.2 Motivations and aims for this report

The primary objectives of the project are to inform DSANZ’s policy and broader educational activity.

1. DSANZ wants to make it clear that direct selling is a traditional industry – in fact, the very first retail model. It is noted that direct selling is not pyramid selling; high-pressure selling is not part of the model; and there is a lack of evidence direct selling gets a lot of complaints. Further, like other retailers, direct selling is affected by changing consumer behaviour related to demographic change and digital disruption. Ironically, faced with these challenges, the holy grail for big retail is ‘relationships

with customers' and 'experiential selling'; in fact, these are the cornerstones of the direct selling model (and of the local shopping strip that has been replaced by big retail).

2. DSANZ is concerned that the importance of the industry, including its social significance, is not recognised by government agencies. For example, Statistics New Zealand fails to separately account for the industry in the official retail trade publication. DSANZ wants to emphasise the social benefits of the direct selling model to the ISPs (and customers); the demographics of the salesforce; an avenue (back) into the workforce or to building a business; relationships with customers and; training.
3. DSANZ is also mindful that there is not much known about the economic contribution of the direct selling industry. As such, it seeks an economic contribution study which, along with the relevant salesforce data will make politicians aware of its value and importance to the economy.
4. DSANZ sees this as a landmark which will enable additional themes for research to be undertaken that further explores the nature, contribution and benefits of direct selling in New Zealand.

The study aims to position the channel's social and economic contribution in an increasingly integrated retail environment. Retail ownership and distribution systems are diverse. Ownership ranges from small unincorporated traders to large, often transnational, entities. At distribution levels, retailing is conducted physically or remotely. Physical selling occurs in store and non-store settings. Non-physical, remote, selling has many forms and is increasingly undertaken in an online environment.

1.3 Approach and methodology

Outlined below are the phases of this research project and the associated methodology.

1.3.1 Scoping Study

A scoping study was conducted to develop a framework for the surveys and social and economic impact analysis of direct selling in New Zealand. It comprised:

- establishing a framework for the current research and for future analysis;
- a literature review of publically available local and international information on the direct selling industry Appendix D;
- consulting with stakeholders including the DSANZ and the Direct Selling Association of Australia (DSAA) and a cross section of direct selling organisations;
- identifying gaps in knowledge about the direct selling industry by the general public and policy makers; and
- identifying the key themes to be addressed in the project.

1.3.2 Surveys

The survey phase involved an online survey of direct selling organisations and independent sales people, to fill in the gaps identified in the initial phase of the project, and provided examples to illustrate key messages. The development and testing of the surveys was undertaken as part of the scoping study.

Two surveys were undertaken; a more detailed description of the surveys is outlined in Appendix A. Responses were received from eight of the 45 DSANZ members and 641 ISPs representing 12 DSOs.

1.3.2.1 DSO survey

Initially the intention of the survey was to be a census of all direct selling activities in New Zealand, however, not all DSOs in New Zealand are members of the DSANZ and not all DSANZ members completed the survey. Nevertheless, the DSOs that responded represent a significant sample of the overall industry – spanning different selling techniques, size of organisations and products sold. As the results of the survey are confidential, responses have been de-identified.

With the help of the DSANZ all members of the association were given the opportunity to complete the survey. The aim of the survey was to fill the existing data gaps and provide an ongoing evidence base for the direct selling industry. As part of this the surveys aimed to:

- gather the information necessary to place direct selling within the broader retail landscape;
- obtain a profile of the industry and to test negative perceptions of the industry; understand the relationship between DSOs and sales people and final customers; and
- to gain an understanding of the regulatory environment facing DSOs.

1.3.2.2 ISP survey

With the help of both the DSANZ and the association members the ISP survey was distributed to a significant share of the salesforce of the DSOs. The aim of the ISP survey was to understand:

- the demographic profile of ISPs in the direct selling industry;
- the motivations of ISPs for their involvement in the industry; and
- the participation and benefits of being in the industry.

1.3.3 Economic contribution

The survey data was used to gather information on value added and employment in the industry, financial data from both DSOs and ISPs was compared and cross referenced to estimate the dimensions of the industry based on the responses to the survey. Additional information on revenue of all DSANZ members was used to gross the numbers up to a more representative industry total. However, DSOs and ISPs outside of the DSO membership were not accounted for in the estimates.

Background research showed interests of the key stakeholders in the industry – the firms (DSOs), distributors (ISPs) and customers – are often closely intertwined. For example, ISPs are engaged as independent contractors rather than as employees of a DSO. The result is that ISPs have autonomy over the day to day functions of their selling and business operations. The DSO retains control of quality assurance, intellectual property, and issues of brand and reputation (DSAA, 2012). For consumers, the distinction between ISPs and DSOs does not necessarily matter so much; for issues such as quality and reliability of the product purchased, they may be viewed as a single entity.

Consequently, the findings in this report have been organised according to a number of common themes. Each of these themes is addressed in more detail in the remainder of this report.

- Chapter 2 describes the **nature of the business**, essentially defining the place of direct selling in the retail landscape;
- Chapter 3 outlines the **social contribution** of the direct selling industry, and provides an profile of the sales force and customers in the industry; and
- Chapter 4 outlines the **economic contribution** of the direct selling industry in the New Zealand economy;
- **Challenges for the industry** are discussed in Chapter 5, this includes regulatory and other issues that affect the day-to-day activities and viability of the direct selling industry.
- Chapter 6 **concludes** with key messages about the social and economic contribution of direct selling and challenges the industry faces. The chapter also looks at outstanding issues that were not answered in this report and areas for future research.

2 The nature of the direct selling business

This chapter comprises a review of the most relevant literature and available data and a summary of consultations with selected DSOs. The data and literature review illustrated a number of key themes which characterise the direct selling industry. These are outlined in this chapter and include:

- direct selling is a legitimate retail niche in New Zealand, and more broadly around the world; and
- direct selling adds to the competitive retail environment in New Zealand, which benefits consumers and encourages innovation.

2.1 An alternative to mainstream retailing

Direct selling is an alternative pathway through which consumers and sellers interact. While participating in the same activities as the broader retail industry, providing consumers with goods and services, there are characteristics of direct selling which make it a separate and distinct aspect of the retail environment.

An independent sales person performs a similar function to the retailer in the traditional retail channel: the promotion, sale and distribution of goods to final consumers. However, the personal nature of this interaction is a key point of difference between the traditional and direct selling retail channels.

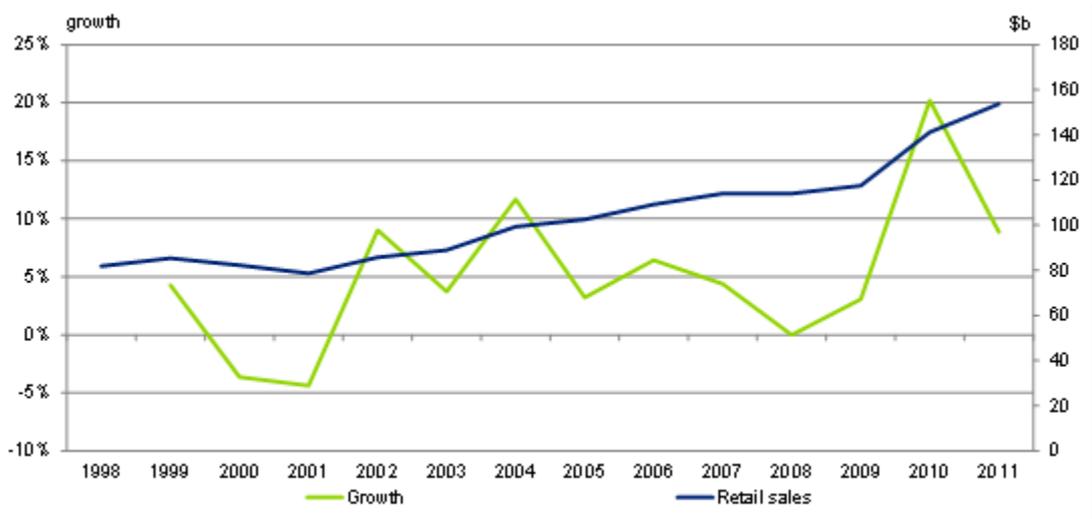
A second key point of difference is the involvement of a sales person in the training and management of a team of sales people beneath them. In this sense, some direct sellers move beyond basic retail selling to activities which are analogous to the owner of a small business or franchise owner.

The DSANZ represents 45 DSOs that access the retail market through the direct sales channel. There are also DSOs operating in New Zealand which may or may not be members of other DSAs but are not members of the DSANZ. These DSOs could be considered as part of the New Zealand industry. Most (around 80%) of the DSOs surveyed had their head offices in the United States. The remaining DSOs had head offices located in New Zealand.

There are also an unknown number of organisations which are part of the direct selling industry, but who are not members of industry groups. Identification of these organisations is difficult, because many are relatively small operations. However, this characteristic means that for the most part the industry is represented by the DSANZ and similar bodies.

Globally direct selling retail sales have increased significantly over the last ten years. Sales rose from around \$79 billion in 2001 to almost \$154 billion in 2011, an increase of 95% (Chart 2.1). Global sales growth has been positive since around 2002, this includes the period of global economic downturn around 2008-09. By 2011, global direct retail sales reached more than \$150 billion globally.

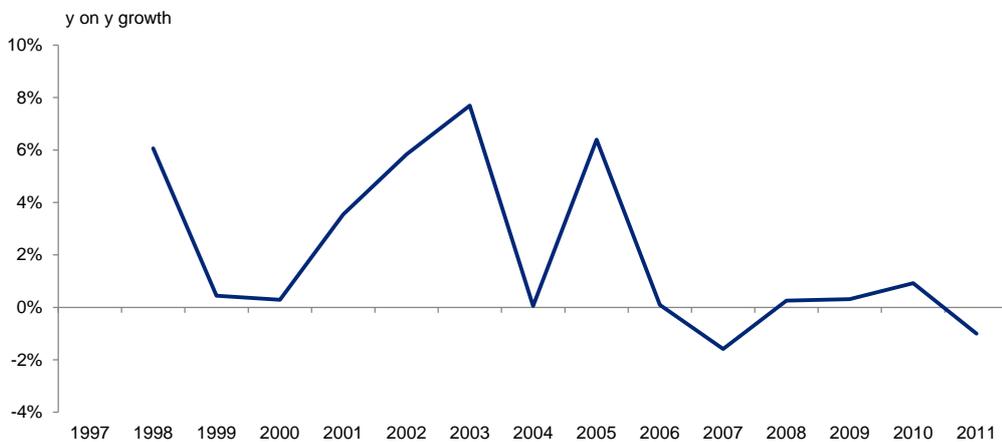
Chart 2.1: Global Direct Retail Sales, 1998-2009



Source: WFDSA

The direct selling industry in New Zealand has been undergoing a period of decline (Chart 2.2). Sales fell in 2006, followed by less than 1% growth for the next three years before declining again in 2011. This downward trend is not apparent in the broader retail sector in New Zealand which has averaged annual growth of 3.4% each year since 2010.

Chart 2.2: Sales growth: 1998:2011



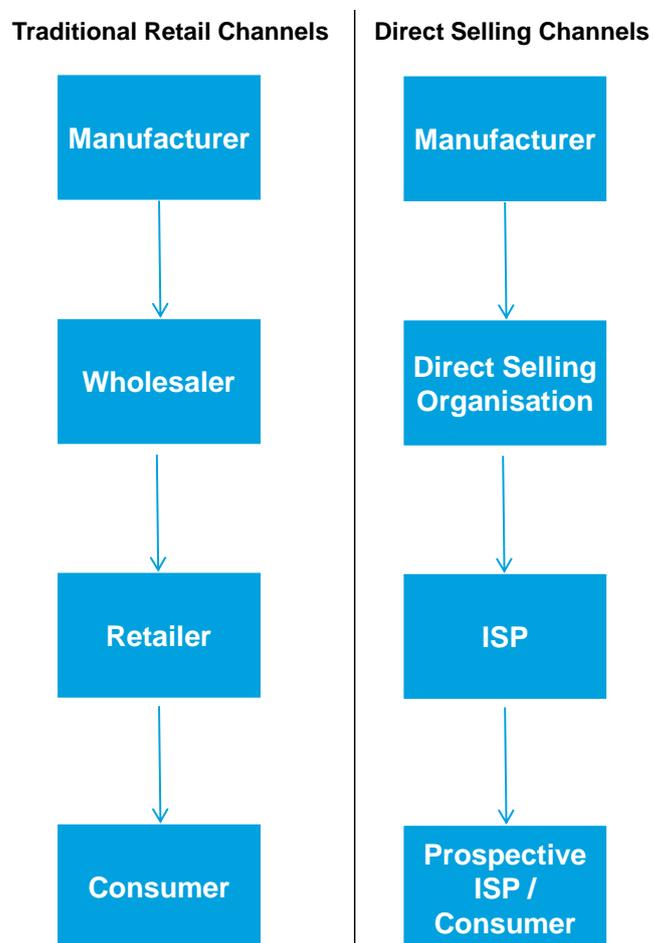
Source: DSANZ

2.2 The retail supply chain

Figure 2.1 demonstrates the similarities along the supply chain between traditional retail and direct selling. Where an independent sales person takes ownership of the goods and services being sold, they are comparable to the retailer in the traditional fixed-location retail channel (Peterson & Wotruba, 1996).

The basic supply chain of the direct selling industry is similar to the traditional retail channels, with some fundamental differences in the final interaction between consumers and direct sellers. For example, a consumer in the direct selling industry is also potentially a prospective direct seller themselves.

Figure 2.1: Retail supply chain



Source: DSAA, 2012

2.3 Organisational models

There are two main organisational models used in direct selling, illustrated in Figure 2.2. An explanation of the remuneration plans used in the different models is outlined in 3.1.4.

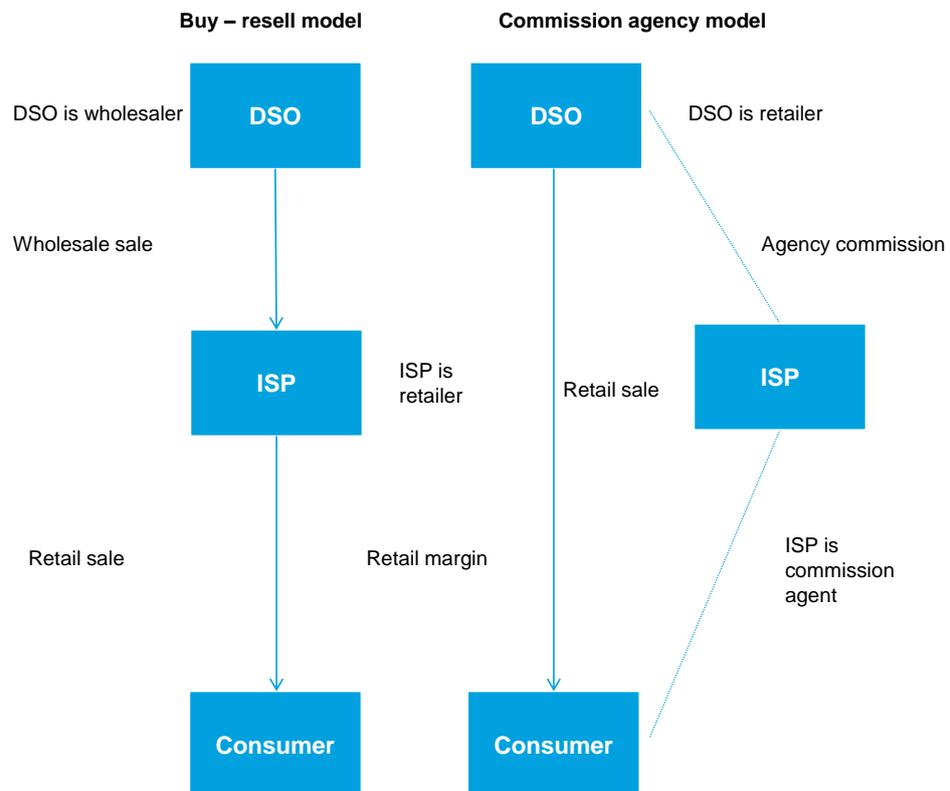
Buy-resell model

Under the buy-resell model the DSO sells goods to the ISP at the DSO's wholesale price. The ISP is then authorised to re-sell to the retail consumer, at a retail price that they choose (there are recommended retail prices, but the final price is set at the discretion of the ISP). The income earned by the ISP is the margin between the wholesale purchase price and the retail price (which is usually set according to the DSO recommendation), *plus* any commissions or bonuses payable under the DSO's compensation plan, *less* any costs incurred in selling (such as associated travel to party plan events).

Commission-agency model

The DSO appoints the ISP to act as an independent facilitator of the sale of goods or services, with the transaction taking place between the DSO and the retail consumer. For example, an ISP will sell a product to a consumer and the DSO will then deliver the product to the customer without the ISP gaining legal title over the goods. Income earned by the ISP consists of the commission on the retail sale plus any other commissions or bonuses payable under the applicable compensation plan.

Figure 2.2: Organisation of DSOs



Source: DSAA, 2012

2.4 Direct selling organisations operational business models

DSOs in New Zealand operate according to one or more business methods:

- party plan;
- network marketing; and
- door-to-door/catalogue (direct marketing).

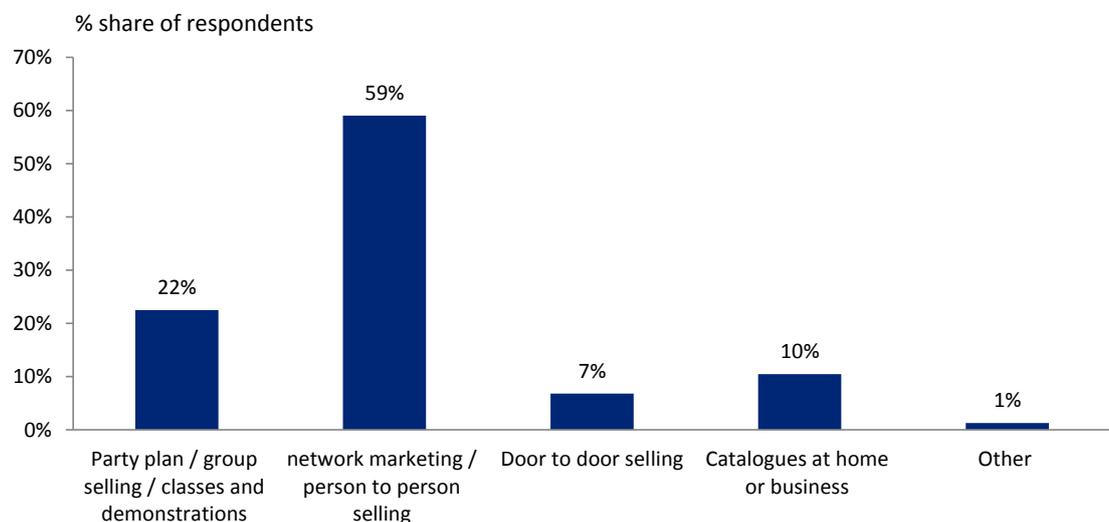
These methods replace traditional or alternative retail methods such as in store selling or distance selling.

Party plan is the most well-known direct selling model. This is where parties are used to generate sales of goods and services. Generally a prospective purchaser is invited to the home, workplace, or other setting by a host (who is not the ISP), with products then demonstrated by the ISP and sold to participants. Subsequent purchase of goods online is not uncommon with this method of direct selling.

Network marketing is a process in which ISPs will establish and maintain relationships that result in the sale of products. These relationships are not confined to a home or workplace and introductions may be solicited or unsolicited. There is a tiered compensation structure for ISPs involved in network marketing; ISPs earn income through the sale of products and as a percentage of sales for ISPs who they have 'sponsored' (recruited and trained). The tiered structure can sometimes be across several levels.

Door-to-door/catalogue is the process where cold canvassers doorknock prospective consumers. This may involve the ISP delivering and picking up catalogues without any interaction with the consumers, and physical contact between the ISP and consumer might not take place until delivery of the product. Unlike the other direct selling methods door-to-door selling involves little, if any, recruitment activity by ISP's.

Chart 2.3: Business models



Source: Deloitte Access Economics, DSO survey. *note respondents could select more than one option.

A majority of DSOs surveyed participated in either party plan or network marketing. While around 10% of DSOs undertook catalogue selling only 7% reported door to door selling as a model that they used. This is an important departure from traditional direct selling activities and indicates that the industry has evolved over time.

Many DSOs which were previously only door-to-door or party plan are now using a combination of selling methods, e.g. some DSO's utilise both direct selling and online channels to sell kitchenware. This demonstrates the flexibility of the industry to respond to the changing retail environment.

2.5 Goods and services suited to direct selling

Most goods and services sold through traditional retail channels can be sold through the direct selling channel. However, there are some products which are particularly suited to direct selling methods. This includes goods which are distinctive; require some form of demonstration (e.g. cookware); and result in repeat sales (e.g. cosmetics).

Products and services which have a higher personal selling elasticity are suitable to the direct selling method. Higher personal selling elasticity is associated with goods where postponement of purchase is easy, such as cosmetics and nutritional products. Overcoming this requires concentrated personal attention to individual consumer differences. Chart 2.4 that in New Zealand the two products most sold by DSOs were wellness products and cosmetic goods.⁴

Items which benefit from personal demonstration are particularly suited to the direct selling. As the selling and purchasing interaction generally takes place in home environment in direct selling, it is an effective strategy when the product involved is a household item. An example of this type of product is cleaning goods.

Some products are suited to direct selling – more so than the broader retail industry – while other products are suited to specific direct selling methods. For example, fashion products are suited to party plan, and weight management products are suited to network marketing (Williams, 2009).

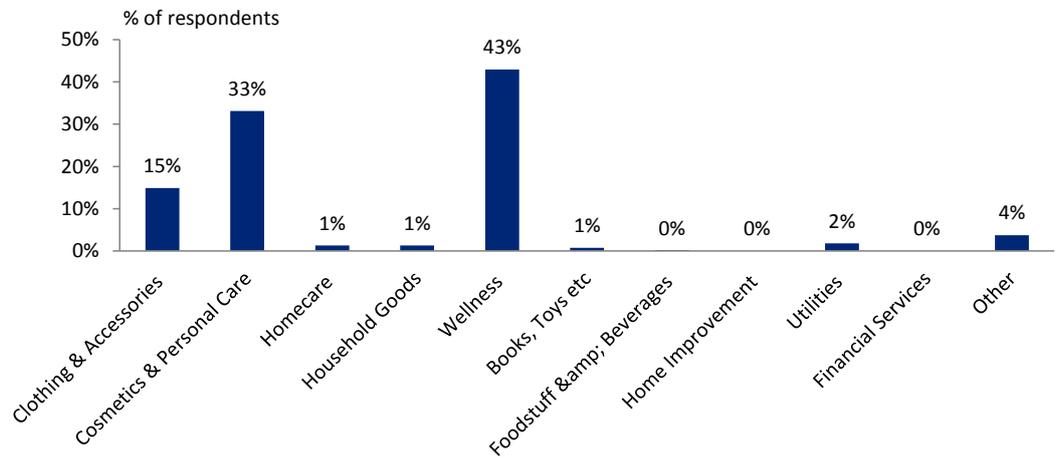
The party plan approach is an effective strategy for products that might benefit from reference group interaction among prospects attending the party (e.g. jewellery, children's books and education material) (Peterson and Wotruba, 1996).

Similar to the direct selling industry, the New Zealand retail industry is characterised by a significant share of sales in department store retailing and clothing and accessories retailing, both representing around 15% of total core industries (New Zealand, Retail Trade

⁴ The categories outlined in Chart 2.4 include: **services** – telecommunication; **personal** - cosmetics, fragrances, skincare, personal care, jewellery, fashion accessories, clothing, personal colour and image products; **food and health** - food supplements, nutritional supplements, sports drinks and foods, health foods, weight loss and management products, fitness, aromatherapy, magnetic therapy products, therapeutic massage equipment, water filters and air purification system, wines; **household** - kitchenware, homewares, manchester, furnishings, candles and associated products, cleaning products and systems, car care, security; and **family** - books, toys, games, audio visual, gifts, arts and crafts, personal development products, pet care, photo safe albums and supplies, educational materials (DSAA, 2013).

Survey, June 2013).⁵ Wellness and personal care products make up a much larger share of the direct selling industry than the New Zealand retail industry more broadly.

Chart 2.4: The primary product sold by DSOs



Source: Deloitte Access Economics, DSO survey

⁵ Core industries includes all retail industries, excluding motor vehicles and parts and fuel retail.

3 The social contribution of direct selling

There is an important social element that the direct selling industry contributes to the New Zealand community in addition to the economic contribution outlined in Chapter 4. This chapter provides a socioeconomic profile of those involved in the direct selling industry, including a regional profile of sellers. The chapter highlights the motivations of sellers and the social benefits that ISPs received from being involved in the industry and the social benefits that they received from being involved in the industry.

3.1 The salesforce

Recruiting and retaining a good salesforce is the key challenge for DSOs. Consequently, issues that determine the healthiness of relationships between ISPs and DSOs are of paramount importance to understanding the industry. The relationship between the DSOs and ISPs is outlined in more detail in Section 2.3 above and 3.1.4 below.

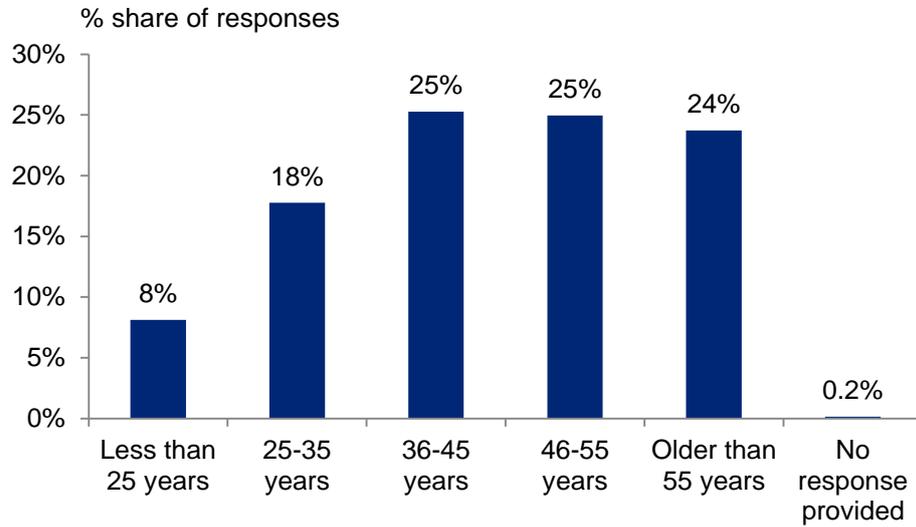
3.1.1 The face of direct selling - independent sales people

The literature on direct selling suggests that many sellers involved in direct selling are women, working part time while they have young children. The age and gender profile of ISPs in the industry support this.

3.1.1.1 Age

The age profile of the ISPs shows that just over half (51%) are between 25 and 45 years old. Around one quarter are under 35 which indicates that Generation Y are well represented in the industry.

Chart 3.1: Age profile of ISPs

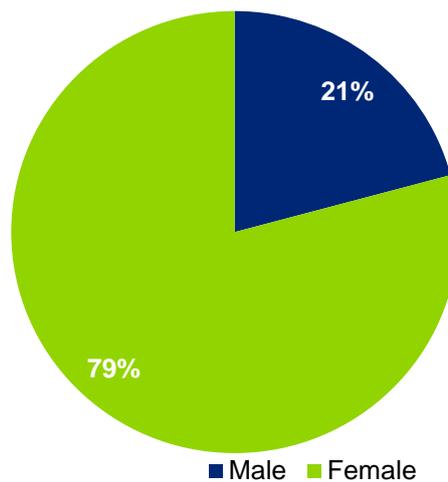


Source: Deloitte Access Economics, ISP survey

3.1.1.2 Gender

The chart below demonstrates that a majority (79%) of the ISPs are female. Leaving aside the target market for the product, male ISPs were much more prevalent in network marketing motivated by the opportunity for them to build a business. Women dominated in party plan models, where the social element of selling was important.

Chart 3.2: ISPs gender: % share of ISPs

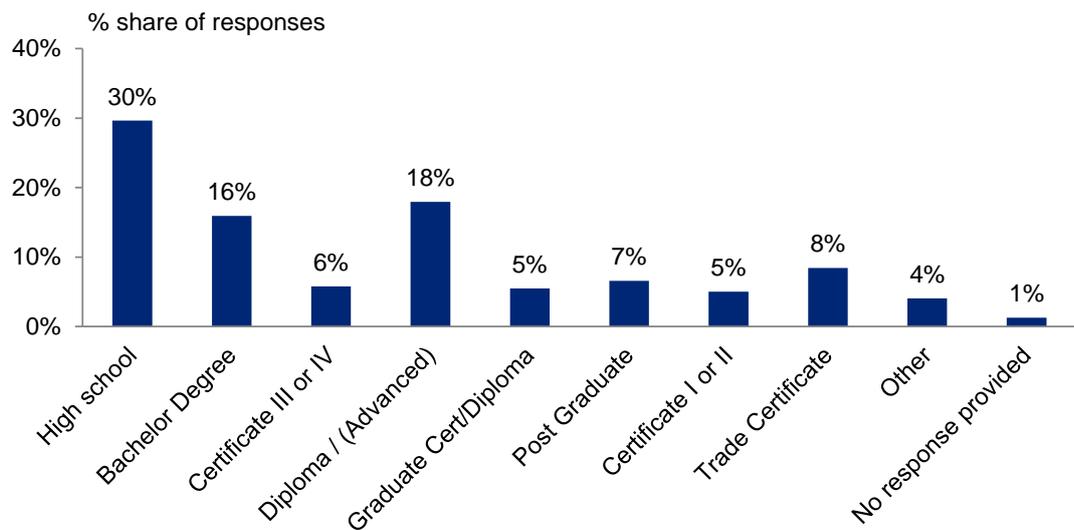


Source: Deloitte Access Economics, ISP survey

3.1.1.3 Education and income

Peterson & Wortuba (1996) found that sellers in the US were more likely to be white, married and have completed high school but not university. Around 30% of the ISPs responding to the DSANZ survey had completed high school and a further 16% had completed a bachelor degree. Around 7% of ISPs had completed some form of postgraduate qualifications.

Chart 3.3: ISP highest educational attainment



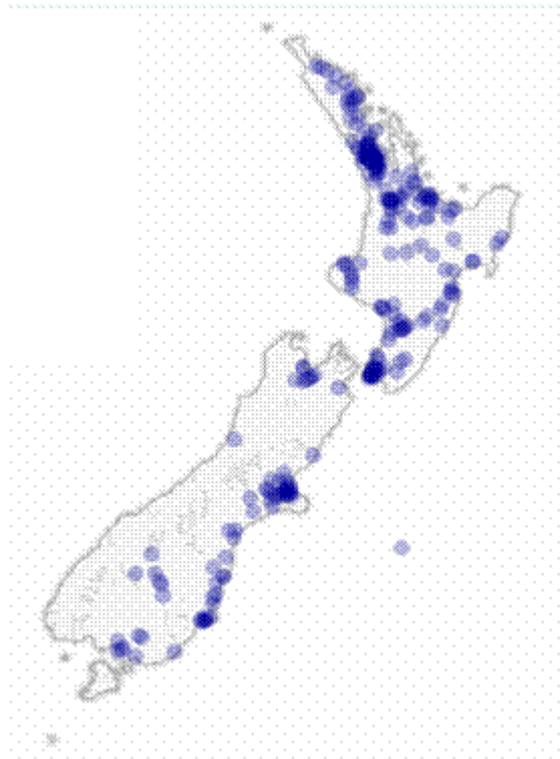
Source: Deloitte Access Economics, ISP survey

Evolving consumption patterns mean that dual income homes are becoming the norm, and the income earned by participants in the direct selling industry is evolving to reflect this. Previously an ISP may have joined the industry for a discrete period of time to earn income for a specific purchase. However, to sustain a continuous second income flow an ISP will need to be more actively, and continuously, involved in the industry. This may mean that an ISP may only be involved for a few hours per week over an extended period of time earning ongoing supplementary income.

3.1.1.4 Where ISPs are most active

Direct selling is present throughout New Zealand. The darker areas represent areas of significant ISP activity. The majority of ISPs reside in the major metropolitan centres as expected, Auckland, Wellington and Christchurch. However, as Chart 3.4 shows there are also significant presences outside the main metropolitan centres, with many ISPs dispersed around the North Island. The popularity in regional areas may be the result of fewer opportunities for social interaction and less choice for retail offerings outside of the major metropolitan areas.

Chart 3.4: Where do ISPs live?



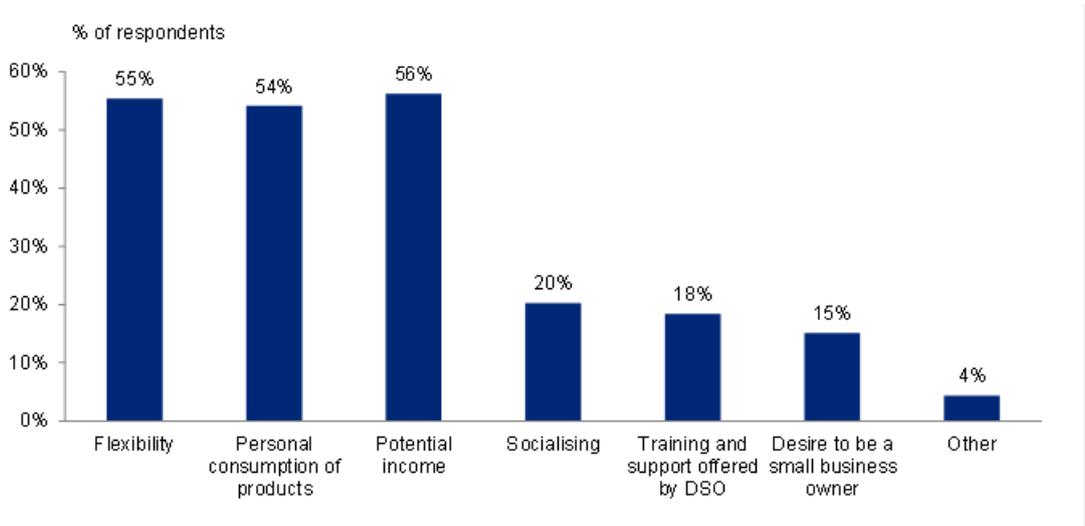
3.1.2 Motivation for entering direct selling

There are a number of reasons for ISP's to be involved in the direct selling industry (Williams, 2009):

- gaining supplementary income;
- flexibility around work hours;
- an entry point for start-up small business owners;
- an opportunity to build confidence;
- make new friendships; and
- nourishing personal and professional development.

More than half of the ISPs surveyed indicated that personal consumption was one of the reasons for membership of their DSO. The low-risk entry into the market and the ongoing business support offered by the DSOs was another primary motivating factor for ISPs (Monash, 2010).

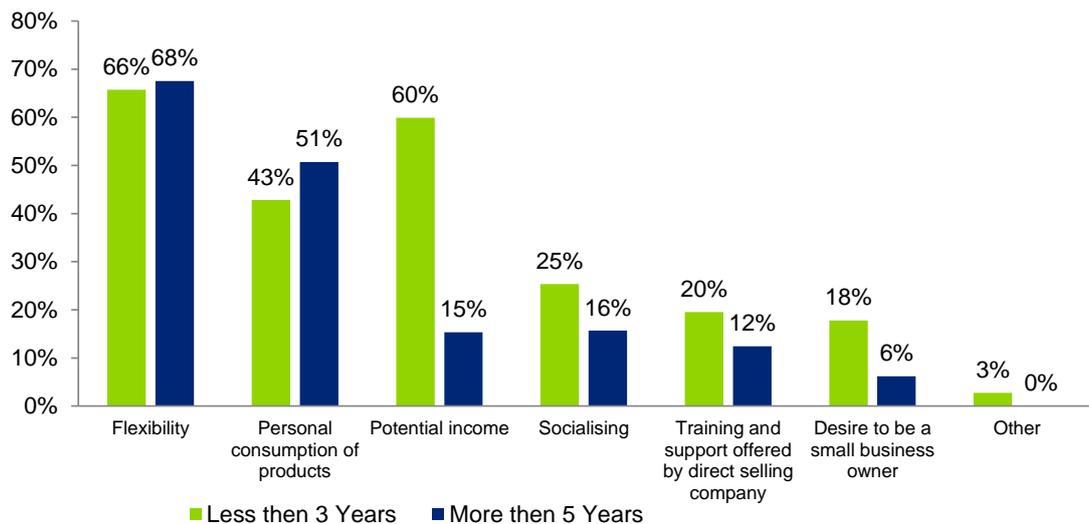
Chart 3.5: Motivation for involvement in industry



Source: Deloitte Access Economics, ISP survey. Note: respondents were able to select more than one response.

While the flexibility and the ability to personally consume products motivates both new and experienced direct sellers, noticeably income and socialising is a far more prevalent motivation for new ISPs. ISPs involved in the industry longer than five years were more likely to be motivated by personal consumption, while those new to the industry were much more likely to be motivated by potential income and the flexibility offered by the industry.

Chart 3.6: Motivation for involvement in industry: comparison



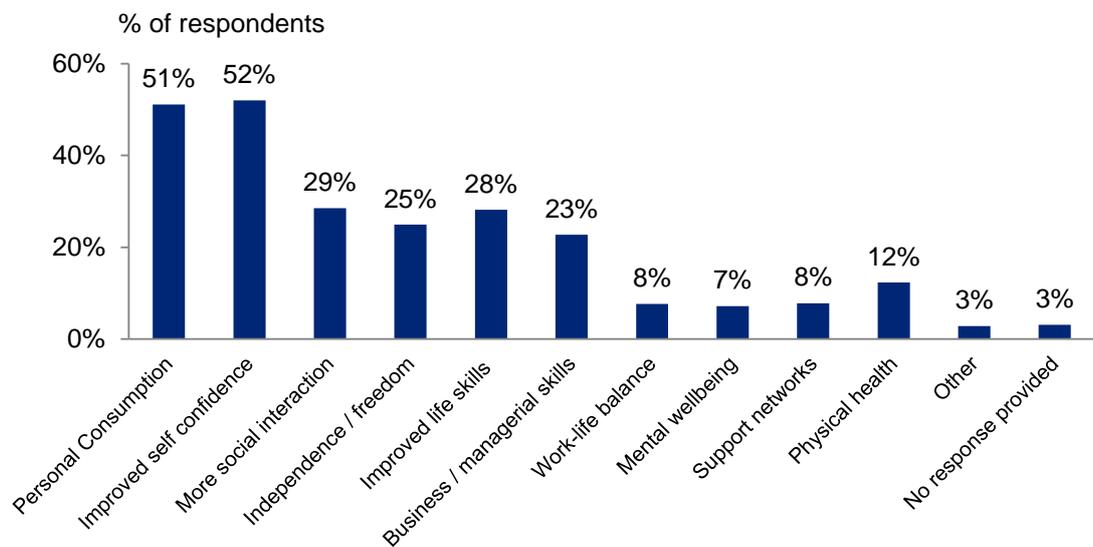
Source: Deloitte Access Economics, ISP survey. Note: respondents were able to select more than one response.

3.1.3 ISP’s experience of direct selling

The direct selling industry is a unique part of the broader retail environment in New Zealand. The benefits that the industry offers to its sales force are one of the driving factors for their involvement.

3.1.3.1 Benefits for ISPs

Chart 3.7: ISP benefits



Source: Deloitte Access Economics, ISP survey. Note: respondents were able to select more than one response.

Slightly more than half of the ISPs surveyed said that personal consumption of goods – typically at below retail prices – was a benefit from being involved in the industry. This benefit is unique to the direct selling industry.

More than half of the survey respondents sighted improved self-confidence as a benefit from being involved in the industry. This is supported by the literature which highlights an opportunity to build confidence as an important reason for ISP involvement in the industry. The opportunity to improve both life and business skills are also important benefits to a number of ISPs. These reasons, combined with improved self-confidence, suggest that the direct selling industry is playing an important role in developing the entrepreneurial skills of a group of New Zealander’s (especially women aged 25-45 years) that otherwise might not have the chance to develop.

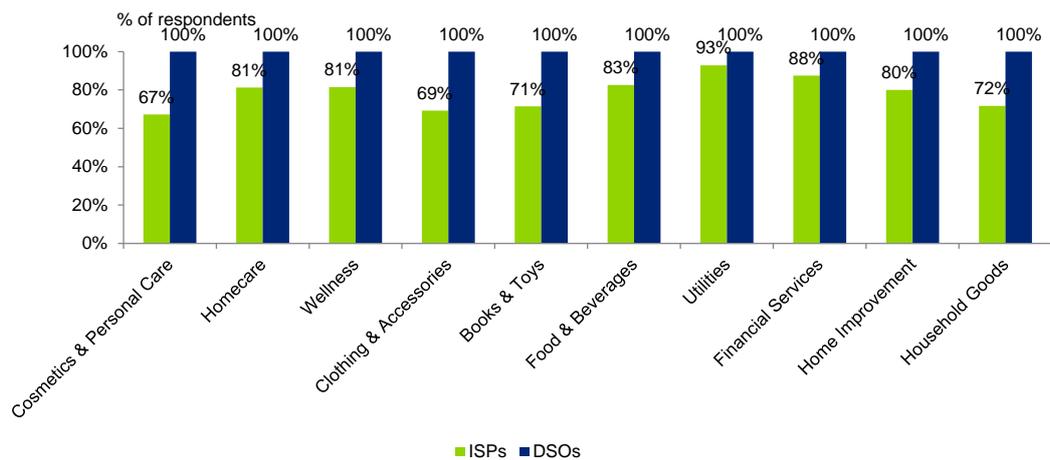
There are additional social and individual benefits gained through employment. Unemployment is associated with personal financial hardship and poverty, debt, homelessness and housing stress, family tensions and breakdown, boredom, alienation, shame and stigma, increased social isolation, crime, erosion of confidence and self-esteem, the loss of work skills and ill-health (McClelland. A and Macdonald. F, 1998). By providing flexible employment opportunities for ISPs the direct selling industry is contributing to reducing the social costs of unemployment in New Zealand.

3.1.3.2 Support from DSOs

Consultations indicated that training is an integral part of the ongoing development of ISPs in order to maintain longevity in the business. Training can be tailored to suit the skill level of the ISP, this has been made easier through the use of technology, including, e-learning and webinars, which allows ISP’s to receive training at their level and in their own time, and gaining experience through observing at parties before running a party.

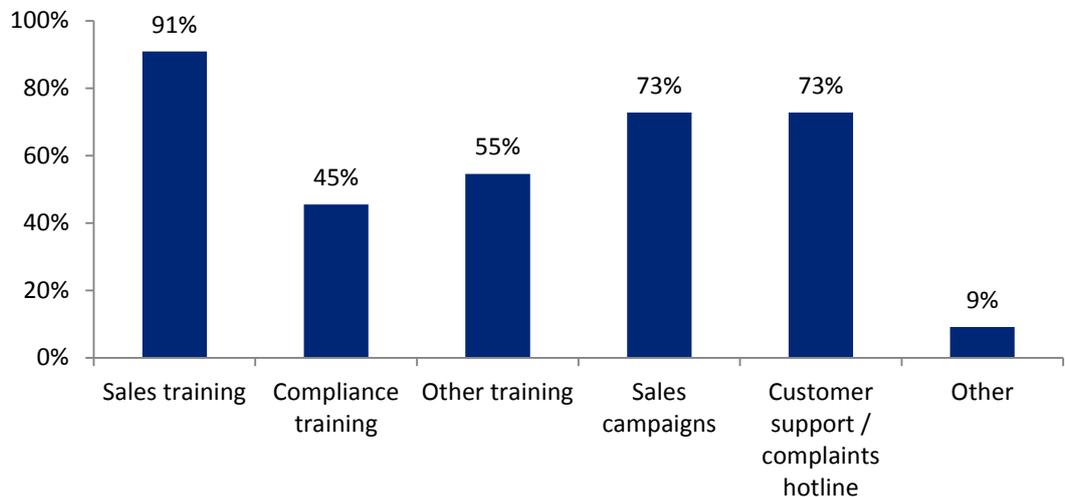
Most ISPs receive some training, with more than 70% of ISPs in most product areas stating that they have received some training. All DSOs report that they have delivered training. In general, the numbers of ISPs and DSOs stating that they had given or received training are similar, albeit with some differences. For example, 100% of wellness DSOs stated that they had delivered training while only 81% of ISPs in the same product area stated that they had received training. The discrepancy may reflect training being provided by other ISPs rather than the DSO or training only being available for more senior ISPs.

Chart 3.8: Training provided and received



Source: Deloitte Access Economics, ISP survey. Note: ISPs were asked if they had received training in the last 12 months, the share of DSOs is based on those which indicated they delivered training.

The DSOs surveyed stated that they provide a number of different types of support to their ISPs. Almost all (91%) of the DSOs surveyed stated that they provided sales training to ISPs, more than 70% of DSO respondents provide their salesforce with customer support. Around three quarters of the DSOs surveyed provide additional support around sales campaigns. This suggests that DSOs recognise the importance of providing initial, ongoing and specific support to their ISPs.

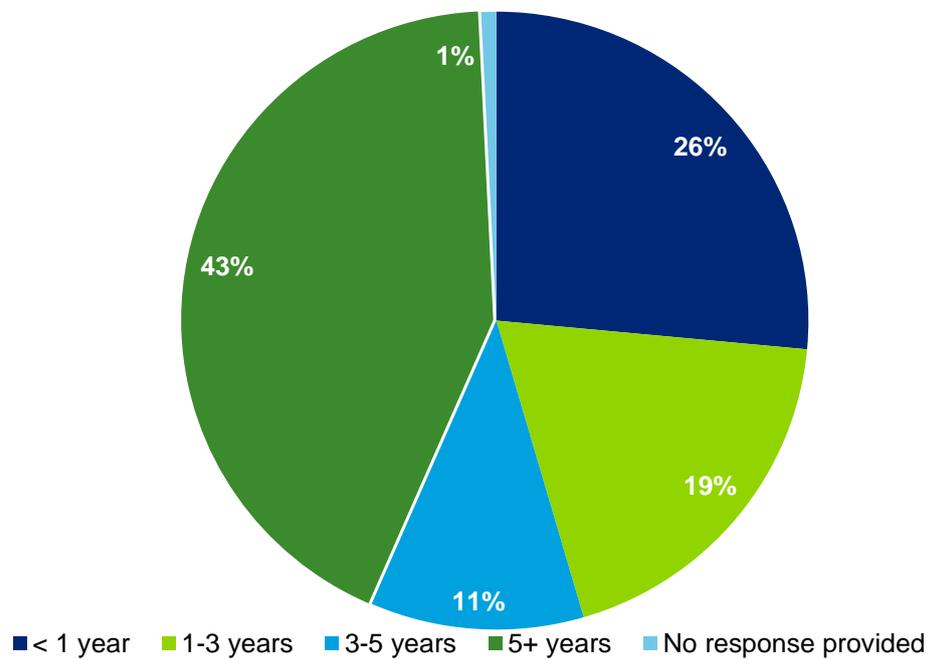
Chart 3.9: Support from DSOs

Source: Deloitte Access Economics, DSO survey.

3.1.3.3 ISP staff turnover

The challenges faced by ISPs in the direct selling industry are primarily reflecting issues working in a sole-employee business, such as time management, problems of isolation and additional administration tasks. The possibility of negative attitudes of friends and family was also highlighted as a challenge for some ISPs.

The ISP survey supports this reservation as slightly more than one quarter of the sales force has been involved for less than a year. At the same time, the survey suggests that around 30% of ISPs had been involved in the industry for more than three years. Employee turnover for all New Zealand in the quarter to June 2012 was estimated by Statistics New Zealand to be 15.9%. Thus, the turnover rates in the direct selling industry are above the national average.

Chart 3.10: ISP duration in the industry, % of respondents

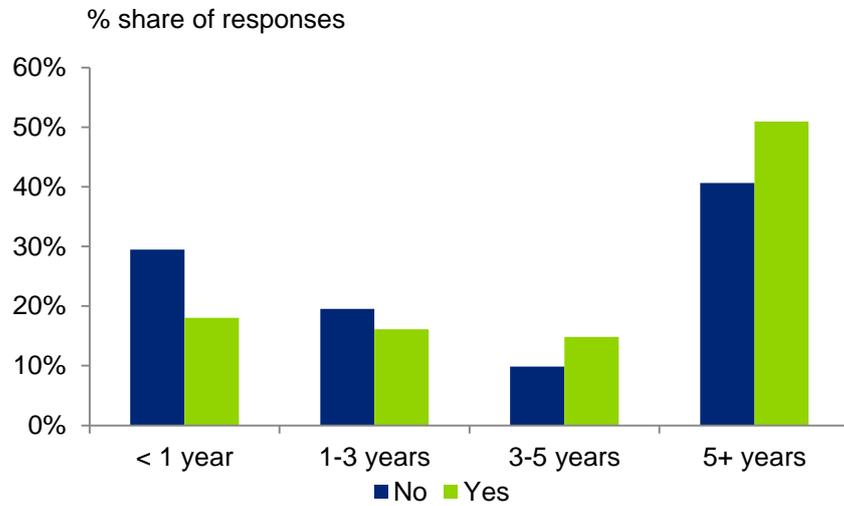
Source: Deloitte Access Economics, ISP survey

If ISPs join the industry mainly to purchase consumable products (as distinct from durable goods, or non-repeat items) at wholesale prices for their own use, then it is not obvious why they would leave the industry. Comparing turnover rates to rates on purchase for own consumption could shed some light on this issue. Around 50% of respondents said they bought goods for personal consumption and 54% of respondents were still in the industry after three years.

There are costs in recruiting and training new ISPs to work in the industry. Hence, DSOs in the industry have a strong motivation to retain existing ISPs, to avoid the cost of recruiting and training new ISPs.

The greater involvement that an ISP has, the longer their duration in the industry is likely to be. This includes ISPs having a greater role in creating, motivating, training and managing their own team of ISPs, or down line. Chart 3.11 demonstrates that ISPs that spend more time developing their own downline are more attached to the industry, and this is associated with increased retention and lower turnover.

Chart 3.11: ISPs attachment to the direct selling industry

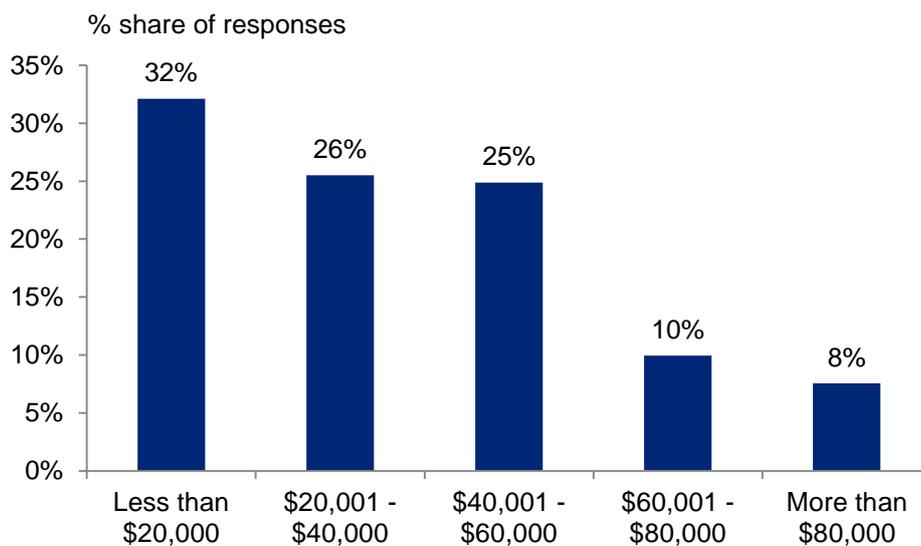


Source: Deloitte Access Economics, ISP survey. Note ISPs were asked if they managed a downline.

3.1.4 Remuneration and rewards for ISPs

The results of the survey have suggested that the direct selling sales force is mostly made up of women, aged 25-45. Further contributing to establishing a profile of the sales force of direct selling is the chart below. This indicates that direct selling predominantly provides a source of income for those with relatively low average annual earnings in all jobs. That is, the direct selling industry is a means for those who may otherwise be disengaged with employment to enter the workforce.

Chart 3.12: Earnings per annum in all jobs



Source: Deloitte Access Economics, ISP survey

There is some public perception that the direct selling industry involves aspects of **pyramid selling**. (A discussion of the pyramid selling issue is provided in Figure 3.1). The high number of ISPs purchasing goods for their own use may lead to this misconception. To guard against this, the DSANZ and its members have well established codes of conduct aimed at reducing the potential of pyramid sellers to be actively involved in the industry. To evaluate this issue some understanding of how remuneration plans actually work is required.

3.1.4.2 Remuneration plans

The two main types of remuneration plans are single-level or multi-level. Table 3.1 provides an example of each remuneration scheme for independent sales people from New Zealand DSOs. An essential characteristic of the direct selling channel is the **independence** of the sales force. This is apparent under each remuneration plan.

In the **single-level** remuneration example, remuneration is based purely on the level of sales. Goods are delivered from the DSO directly to the customer, and as a result, the ISP does not take physical possession of the product at any stage.

By contrast, in the **multi-level** remuneration example ISPs typically take physical possession of the product. The ISP is rewarded based on personal sales and may be eligible to receive additional benefits for sales procured by other ISPs who they have introduced to the industry.

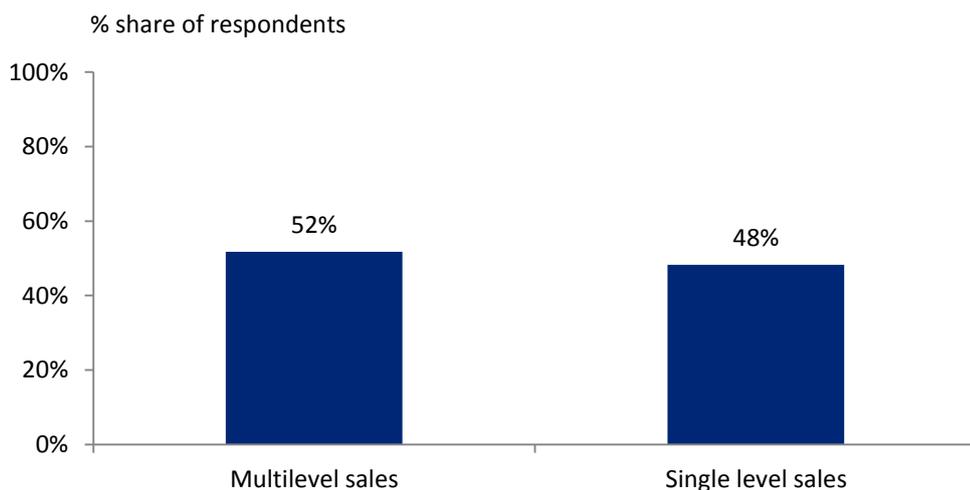
The two above examples are indicative only and there are a number of variations used throughout the industry. Multi-level reward structures exist regardless of whether an ISP has a role in the delivery of goods or whether the ISP is a reseller or agent and supply is directly between the DSO and the consumer.

- For example, in the auto-ship model products are typically periodic consumables e.g. wellness products. An ISP may acquire products for personal consumption and to sell. Income is generated by the margin or commission on products sold and overrides the performance of the downline. Orders are placed with the DSO by the ISP and supply is made by the DSO directly to the ISP, who will either consume or resell.

Table 3.1: Examples of single and multi-level remuneration schemes

| | Single-level (Organisation A) | Multi-level (Organisation B) |
|--|--|--|
| ISP margin on sale | 20% of retail price | 0 – 43% of wholesale price (depending on retail price chosen by ISP) |
| Direct bonus for high sales | 5 - 10% of retail price (if monthly sales of \$5,000 are achieved with commission rising with sales level) | |
| Remuneration from recruitment | N/A | 5% commission on sales of those directly recruited and 9 - 15% commission if personal sales and those of your recruits (and their recruits) reach a certain threshold. A different bonus structure applies if your recruits become executives by recruiting others and meet minimum sales thresholds from their sales and those of their recruits. |
| Conditions for receiving remuneration from recruitment | N/A | Must make 5 retail sales a month and satisfy a minimum order requirement, for the additional 9-15% commission an additional minimum order is required. |

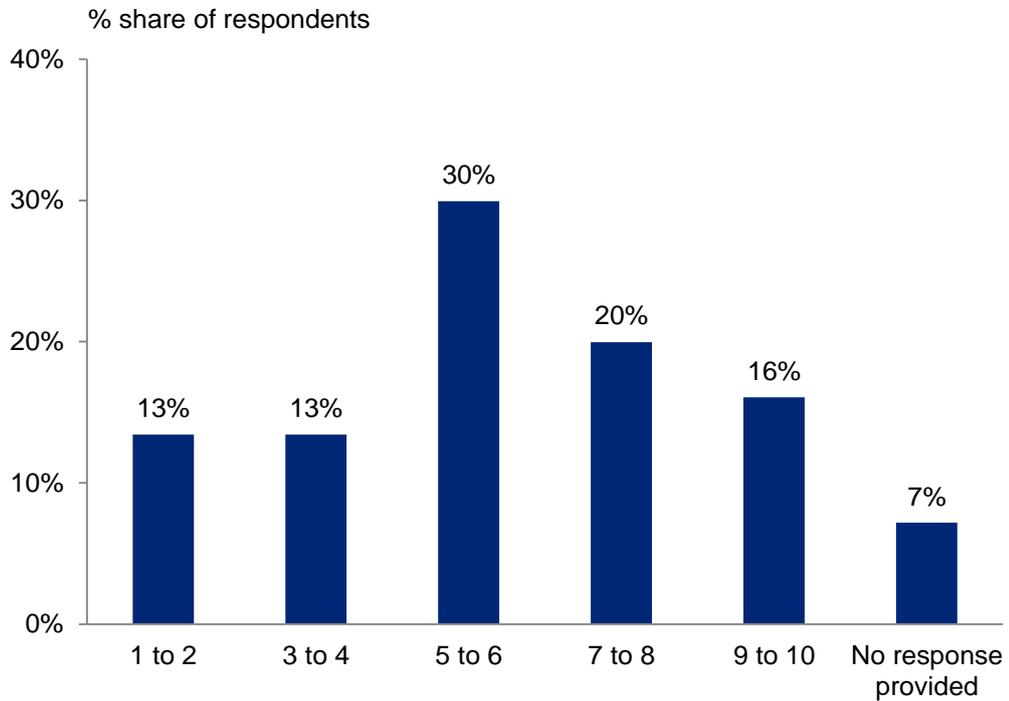
Chart 3.13: Direct Selling sales by compensation structure



Source: Deloitte Access Economics, DSO survey

Around half of DSOs operate according to multilevel sales plans. This suggests that many ISPs may be attracted to the opportunity of setting up their own small business by managing their own downline. At the same time for many ISPs the direct selling industry provides an opportunity to purchase goods for their own use (compare to Chart 3.7).

Chart 3.14: Satisfaction with remuneration



Source: Deloitte Access Economics, ISP survey. Note: The question asked respondents to indicate their satisfaction with remuneration plans on a scale of 1 to 10 with 10 indicating the highest level of satisfaction.

Some 36% of respondents rated their satisfaction with remuneration seven out of 10 or higher. Around one quarter of all respondents indicated that they are less than satisfied with the remuneration plans. Some dissatisfaction with remuneration is common amongst employees regardless of industry. An international survey by Mercer in 2011 indicated that around 50% of women and 44% of men were dissatisfied with their level of pay. Only 26% of the ISP sales force in New Zealand ranked satisfaction with remuneration below five, suggesting that their income is meeting their expectations.

Figure 3.1: Pyramid selling

A number of legal issues concerning direct selling being used as a pyramid scheme have been discussed in the United States. A key issue for the US courts has been the difficulty of distinguishing between legitimate network marketing companies and illegal pyramid schemes. This largely revolves around the definition of the consumer – whether they are ‘inside’ or ‘outside’ the sales network.

The Fair Trading Act prohibits pyramid selling techniques, including referral selling, including the participation, promotion, and inducement of others, to be involved in such schemes. This applies to DSOs, ISPs and their customers, as well as to other members of the retail industry.

The Fair Trading Act distinguishes pyramid selling from multi-level marketing, where income is derived from the number of sales, not from the number of representatives recruited. To ensure compliance with these regulations, compensation plans in the direct selling industry may consist of commissions and bonuses for sales by the ISP’s recruits (and in turn, the ISP’s recruit’s recruits) in addition to earnings for personal sales.

Further, the DSANZ Code of Practice prohibits DSOs and ISPs from engaging in activities which are related to a pyramid selling scheme (DSANZ, 2009).

The multi-level reward system is widely utilised throughout the industry and indeed across a number of other New Zealand industries as well. The key consideration for pyramid selling is a scheme where the principle purpose of the scheme is reward for recruiting irrespective of whether a product is sold. The multi-level reward system is widely utilised throughout the industry. The distinguishing feature of this is that these businesses have the principle purpose of the sale of goods or services and where, if no recruitment occurred, reward for the sale of goods and services would continue.

Whether this is a concern ultimately depends on the extent to which purchases by recruits are converted into retail sales and will differ depending on the precise incentives in each multi-level remuneration scheme. Thomson (2009) noted that in some cases sales to non-participants constituted less than 5% of total sales. Thus, a key metric for identifying the existence of pyramid schemes may be the extent of sales to non-participants, those outside of the network. However, over 50% of ISPs say they buy the merchandise for their own consumption.

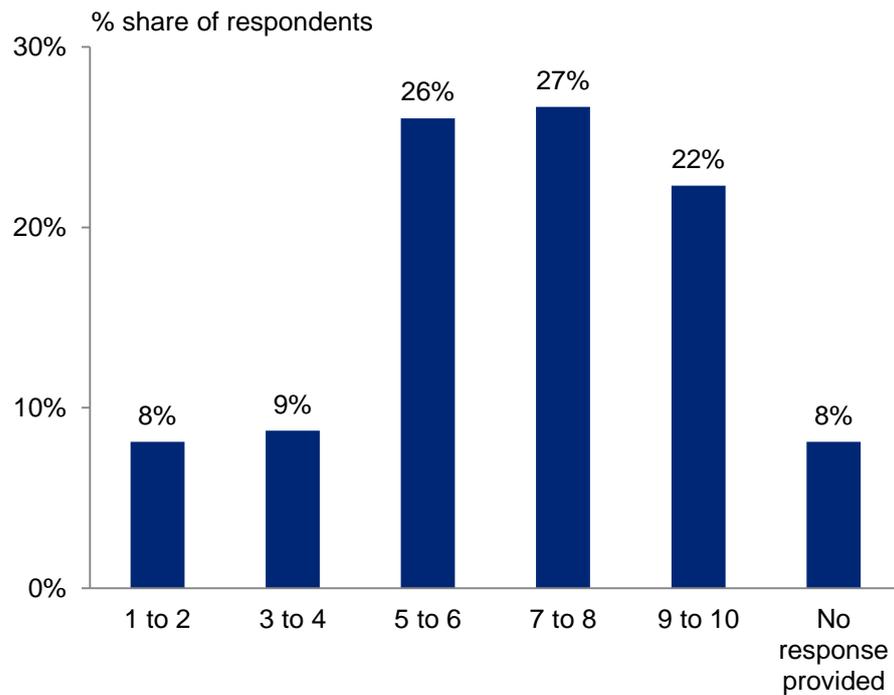
3.1.5 Overall level of satisfaction with industry

Overall, most ISPs say they are quite satisfied with their involvement in the industry (Chart 3.15). Indeed, strong ISP satisfaction across a range of factors was apparent in the survey results, suggesting that in general the sales force is happy to be involved in the industry.

- Around 43% of the ISPs ranked job security as seven out of 10 or higher.
- Around 52% of respondents ranked their social interactions as seven or higher.

- More than 58% of respondents ranked their satisfaction with the flexibility of the work as seven or higher.
- Around 47% ranked satisfaction with the work itself as seven or higher.

Chart 3.15: Overall satisfaction



Source: Deloitte Access Economics, ISP survey. Note: The question asked respondents to indicate their overall satisfaction with the industry on a scale of 1 to 10 with 10 indicating the highest level of satisfaction.

These results suggest that there are a range of reasons why ISPs would choose to be involved in the industry. Satisfaction is not confined to remuneration or flexibility alone. This result is further reinforced by the large share (54%) of the sales force that have been involved in the industry for more than three years.

3.2 The customers

The direct selling industry is a customer-focused industry. Indeed, in a changing retail environment which has seen the rise of online selling and the decline in customer service in the 'bricks and mortar' retail environment, the direct selling industry continues to rely on building strong relationships between buyers and sellers.

Customers were not surveyed directly however, information about customers was obtained from the ISP survey.

3.2.1 Who are the customers?

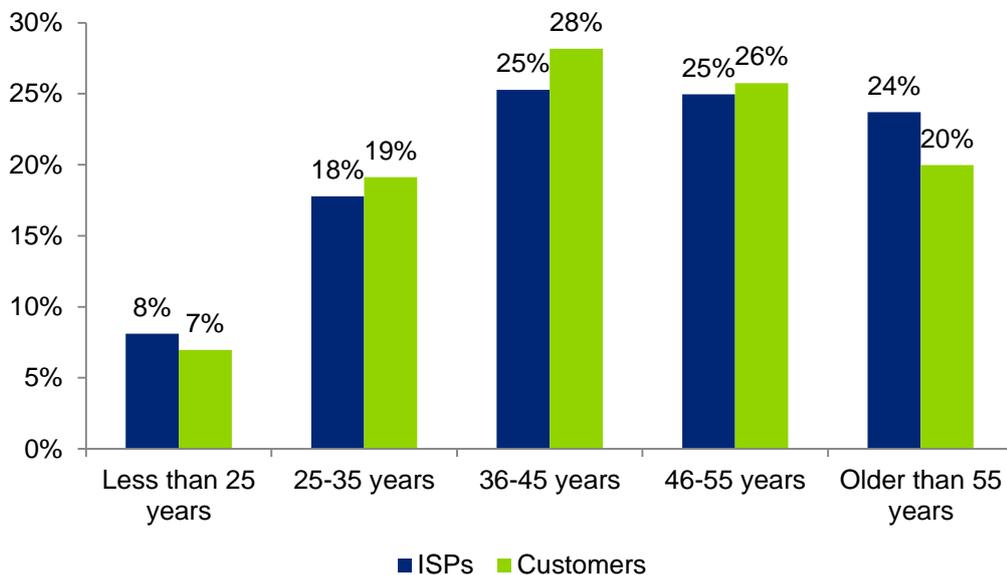
The definition of customers in the direct selling industry is different to the broader retail industry – further demonstrating the sectors unique position in New Zealand’s retail environment.

In the direct selling context, customers include ISPs purchasing products for their own use as well as non-ISP end users of the products.

Information about direct selling consumers is varied, but international studies show they are more likely to be young, female and possess a higher level of education than non-purchasers. Less is known of their demographic profile than ISPs.

The social nature of direct selling suggests the customer base is likely to reflect characteristics of the salesforce and vice versa (Chart 3.16); ISPs are likely to relate to a target market with similar tastes and characteristics to themselves. This raises the issue of how ISPs will be able to successfully sell to other cohorts, e.g. different age groups. This is a challenge for DSOs selling products aimed at older demographics, but wishing to recruit younger ISPs (and customers).

Chart 3.16: Comparison of age



Source: Deloitte Access Economics, ISP survey.

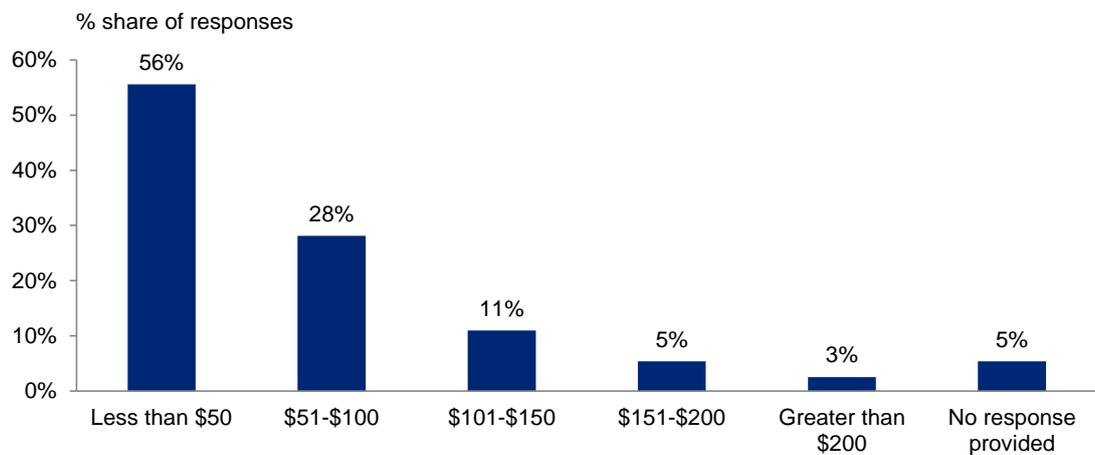
The salesforce and customers of the direct selling industry in New Zealand are more likely to be from older generations, with around three quarters older than 36 years old, and more than half older than 45.

3.2.1.1 Regional selling

Consultations indicated that DSOs enjoy relatively stronger sales in country areas, reflecting limited choice for consumers and the social aspect of party plans magnified by the greater distances between friends and family; in this respect, direct selling has not changed since the days of the travelling salesman of old (see 3.2.2).

3.2.2 Customer spending patterns

Chart 3.17: Average customer spending per transaction

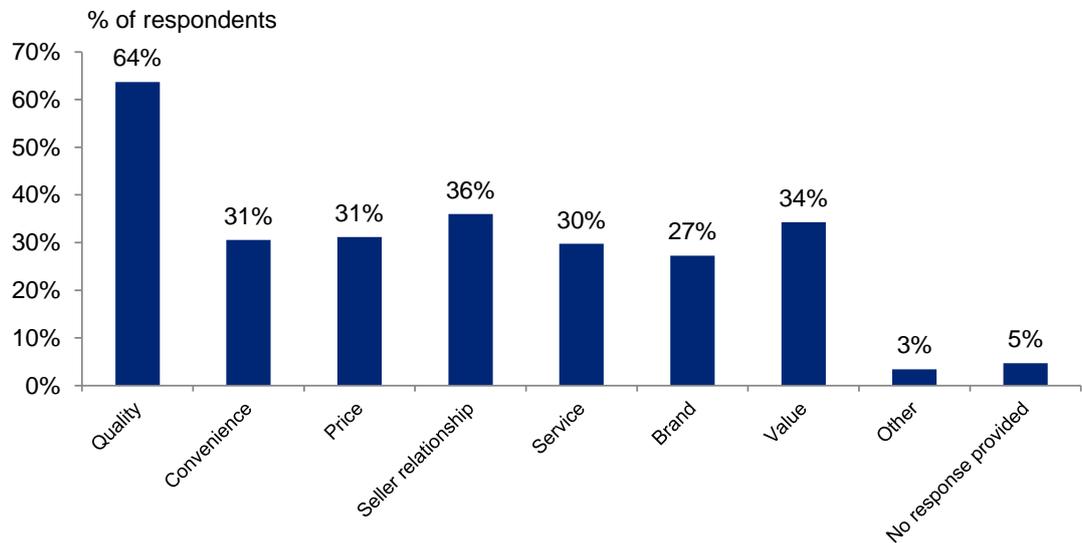


Source: Deloitte Access Economics, ISP survey.

Some 84% of customer transactions are valued at \$100 or below. This suggests that the kinds of products purchased are not expensive big ticket items such as household goods. Chart 2.4 showed that around one third of DSOs in the direct selling industry sell cosmetic goods. Hence, while it is not clear from the data how often items are purchased, it is likely that most purchases are smaller items, purchased more frequently, such as cosmetic or personal care goods.

3.2.3 Why customers choose direct selling

DSOs say that, as they rely on word of mouth, they need quality products. In a survey of eight countries, Brodie et al (2004) found that the primary motivating factors of retail consumers to purchase products through the direct selling retail channel is convenience, product need and appeal. Value for money and the service provided were also cited as motivating factors. From the global sample, social obligation and image of direct seller were the least cited reasons for purchase by consumers.

Chart 3.18: Why ISPs believe their customers purchase their products

Source: Deloitte Access Economics, ISP survey. Note: respondents were able to select more than one response.

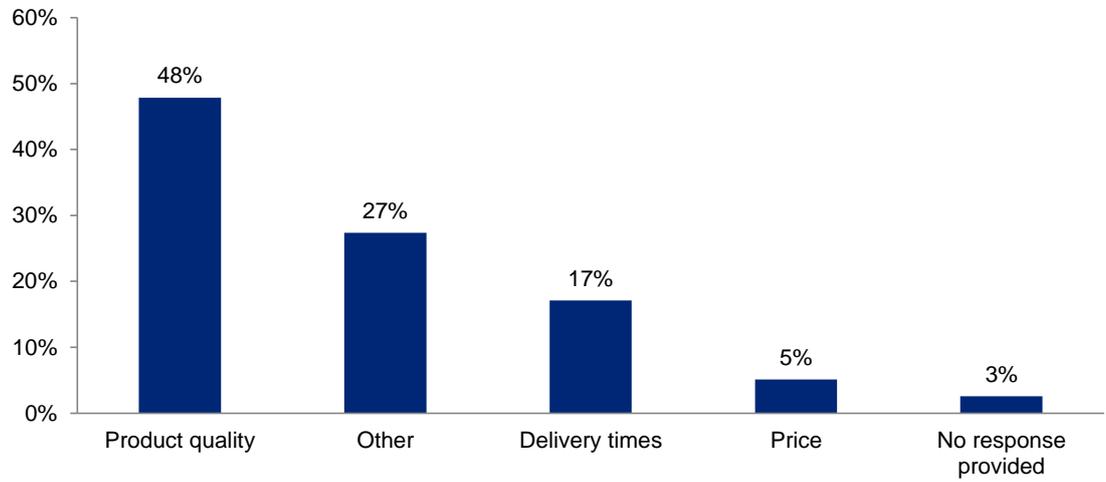
The quality of products sold is what most ISPs believe is the reason why their customers purchase their products.

3.2.4 Customer complaints

Almost all (83%) ISPs surveyed said that they had not received a complaint in the last 12 months. Of those ISPs who stated that they had received at least one complaint in the last 12 months 48% cited the quality of the products as the main reason. Members of the DSANZ are required provide a full money back guarantee of 10 days for goods sold. Most DSOs provide periods of between 30 and 60 days on consumer goods.

The chart below describes the reasons for complaints as reported by the ISPs. It should be noted that while this information is anecdotal, there is no official data that shows that the level of complaints is higher in direct selling than in the broader retail environment or in other consumer industries. Product quality was considered the most important reason for complaints. Most of the DSOs surveyed have formal complaint handling procedures in place.

Chart 3.19: Customers reasons for complaints



Source: Deloitte Access Economics, ISP survey.

4 The economic contribution of the direct selling industry

The direct selling industry makes an economic contribution to New Zealand economy. This Chapter presents the results of the economic contribution study, in terms of the direct and indirect economic contribution of the industry, as well exploring employment, the ISP economic contribution and finally the total economic contribution. An explanation of the methodology employed in economic contribution studies appears in Appendix B.

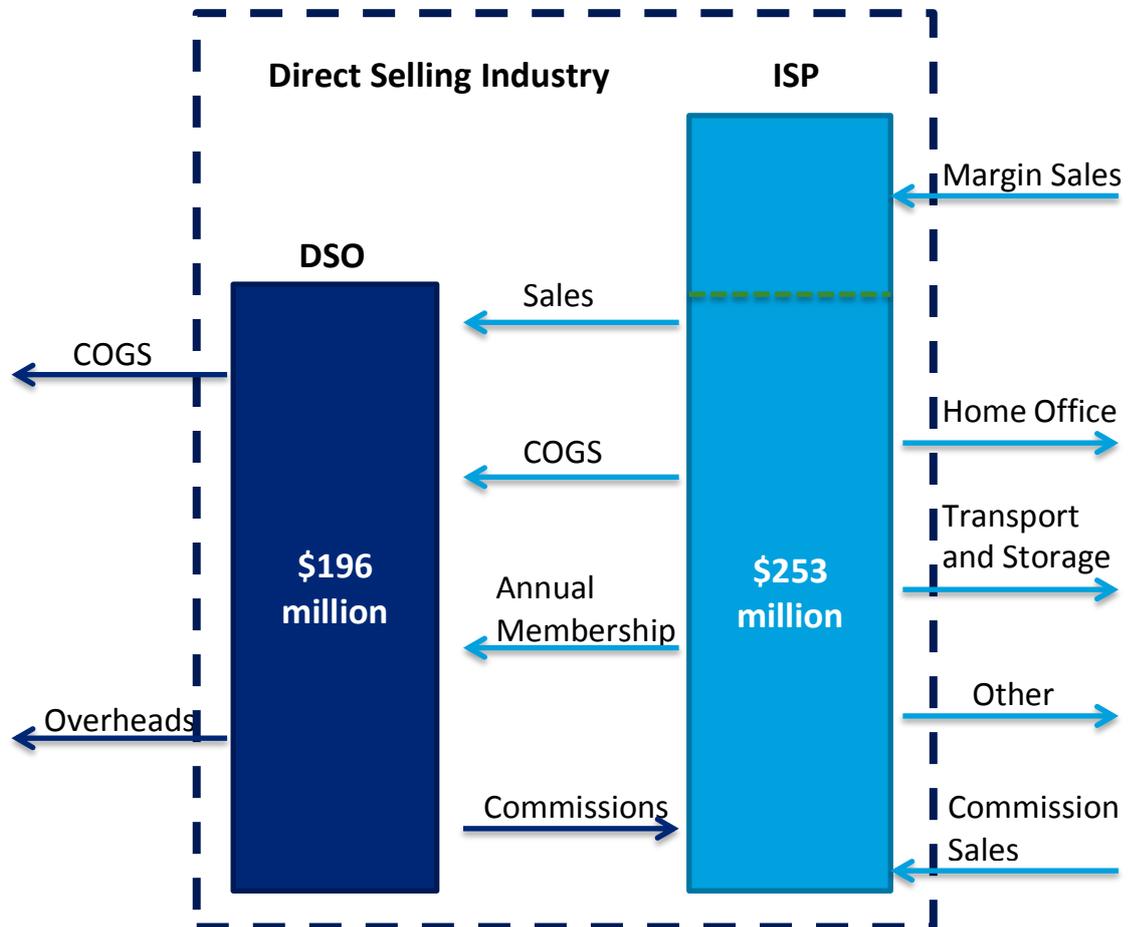
With the aid of simultaneous surveys to New Zealand ISPs and DSOs, this chapter discusses the economic contribution of the direct selling industry to the New Zealand economy, and maps the distribution of revenues from DSOs and ISPs and the flows through to associated sectors that supply goods and services to the industry. This chapter lays out the revenue flows and costs incurred by DSOs and ISPs, before setting out the direct and indirect economic contribution.

In a national accounting framework, the economic contribution is made up of the wages or earnings accruing to labour and the gross operating surplus (GOS). GOS is defined as earnings before interest tax, depreciation and amortisation, or EBITDA. For the purpose of ISPs, all profit is attributed to wages.

As mentioned in Chapter 2, there are two types of payments systems for ISPs, commissions from the DSOs on their sales, or by keeping the margin on buying and reselling the goods. Due to the presence of the commission payments, the relationship between ISPs and DSOs has multiple layers, as the two members have several transfers between each other. These transfers include the commission payments from the DSOs to ISPs, the revenue from commission driven sales, the purchasing of the cost of goods sold (COGS) from the ISPs earning sales margins, and annual memberships. COGS are defined as the value of goods sold during a period; this includes the costs of raw materials including freight, the costs of storing products sold by a business, warehouse overhead costs, and direct labour costs of producing goods.

The flow of payments between industry participants and with associated industries is outlined in Figure 4.1 below. This shows that \$196 million of revenue earned by DSOs flows towards related industries in the form of COGS and overheads, i.e. other industries receive income from DSOs. At the same time DSOs are paying out commissions (and other payments) towards the ISPs. The \$253 million in revenue earned by ISPs flows back towards the DSOs as COGS for goods purchased and towards other related industries as payments for operating expenses (e.g. running a car or home office supplies).

Figure 4.1: Flows of the New Zealand Direct Selling Industry, 2012

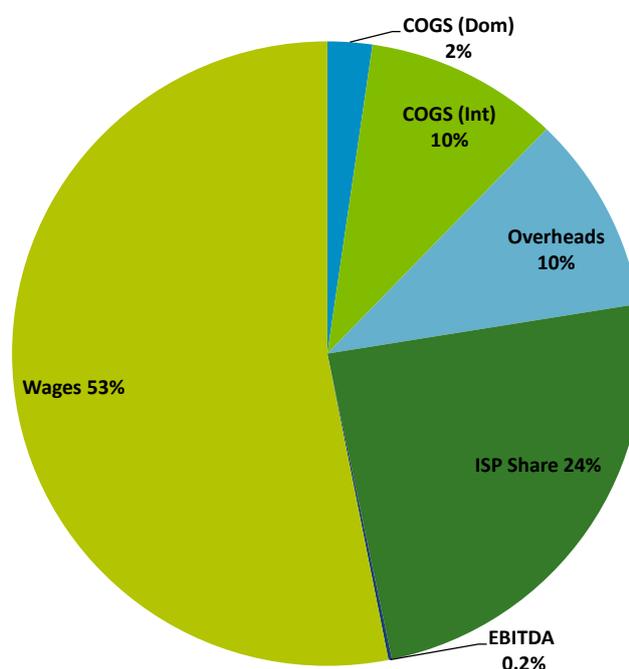


Source: Deloitte Access Economics

4.1 Direct selling organisation

Member firms of the DSANZ reported annual revenue, in 2012 of \$196 million in total. Additional information supplied by the DSANZ showed that the 11 DSO respondents from New Zealand together made up 65% of the revenue of all the DSANZ DSOs. Around 0.2% of DSO revenue was paid out as earnings before interest, tax, depreciation and amortisation (EBITDA).⁶

⁶ EBITDA gives an indication of the current operational profitability of a company, or industry.

Chart 4.2: Average New Zealand DSO revenue, 2012

Source: Deloitte Access Economics calculations

The largest share of DSOs revenue is paid out as wages to its staff, accounting for more than half of total expense. A majority (around 80%) of the goods sold in the industry are sourced internationally.

Table 4.2: New Zealand DSO Annual Revenue Breakdown, 2012

| | \$ million | % |
|----------------------|------------|------------|
| COGS (International) | 19 | 10 |
| COGS (Domestic) | 4 | 2 |
| Overheads | 20 | 10 |
| ISP Share | 47 | 24 |
| EBITDA | 0.4 | 0.2 |
| Wages | 104 | 53 |
| Total | 196 | 100 |

Source: Deloitte Access Economics calculations

4.2 Independent Sales People

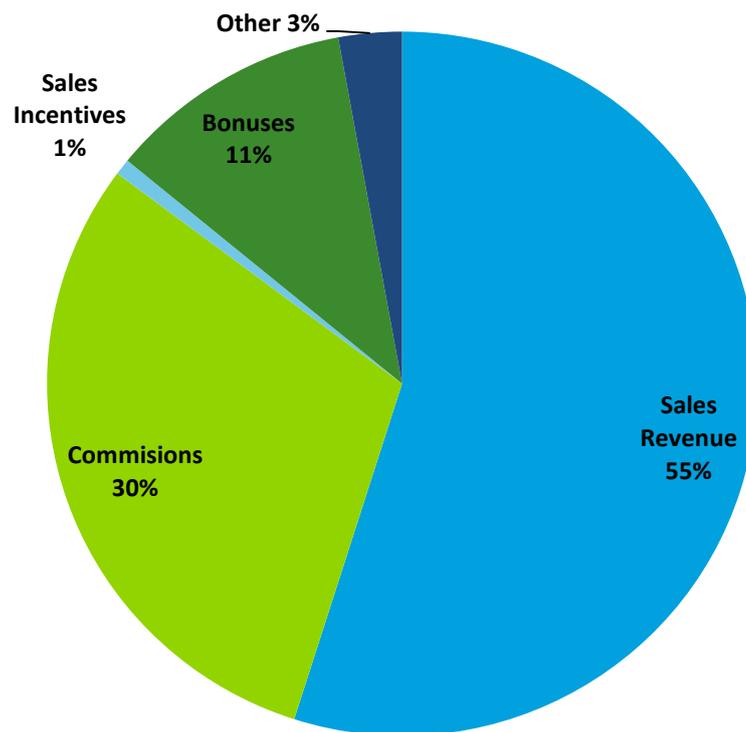
Figure 4.1 shows that 24%, or \$47 million of the DSO's revenue is paid to ISPs in commissions, bonuses and other sales incentives. Many margin earning ISPs purchase from DSOs purely for personal consumption and are not earning an income through the industry. The \$47 million paid to ISPs as commission consists of 45% of ISPs revenue on average.

Retail firms range from full commission (such as a real estate agent) to profiting only from margins on sales (such as restaurants and bars). The difference generally lies within the products being sold, and the risks associated with them. For more expensive items, like

houses and cars (car dealerships), retailers will work off commission. Restaurants and Supermarkets (Countdown, New World and Pak and Save) purchase the goods outright and resell them at a margin.

The mixed source of income below comes from averaging the income stream from both types of ISPs.

Chart 4.3: Net inflows after COGS, for the average New Zealand ISP, 2012



Source: Deloitte Access Economics calculations

Chart 4.3 shows that ISPs receive a majority (55%) of their inflows from margins on their sales revenue and the remaining 45% from DSOs (commissions, sales incentives, bonuses and other).

Table 4.3: Net revenue, less COGS and annual membership, for New Zealand ISP, 2012

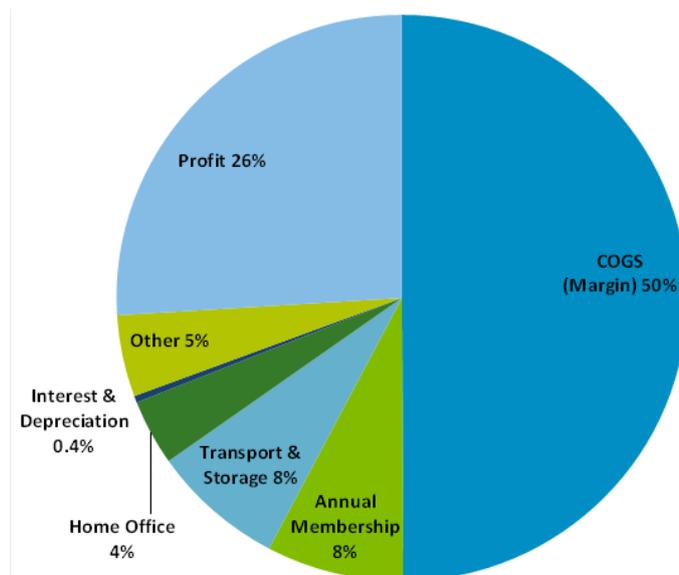
| ISP inflows | \$ million | % |
|--------------------------------------|------------|------------|
| From DSO (Commissions, Bonuses etc.) | 47 | 45 |
| From Sales (Margins on sales) | 58 | 55 |
| Total | 105 | 100 |

Source: Deloitte Access Economics calculations

The total margin on ISP sales, \$58 million Table 4.3 above, is the size of the industry which is not captured by the DSO's revenue. Total margin on ISP sales together with total industry DSO revenue of \$1.13 billion, is added together to estimate the total size of the Industry of \$1.46 billion.

Chart 4.4 demonstrates the revenue split for the average New Zealand ISP. Half of the average ISP's revenue is spent on purchasing the goods outright from the DSOs. This breakdown takes into account all ISPs in the industry, even those who only participate for personal consumption. Note that ISPs purchasing goods just for personal consumption will push up the COGS share of revenue.

Chart 4.4: Revenue split for the average New Zealand ISP, 2012



Source: Deloitte Access Economics

Due to the different income structures, of different DSOs a particular ISP may have a different revenue split. ISPs on commissions have little or no COGS and have a higher share of both profit and other costs, while those working on a margin would have an even greater COGS share.

Table 4.4: Expense Breakdown for all New Zealand ISPs, 2012

| Expense | \$ million |
|-----------------------|------------|
| Payments to DSOs | |
| COGS | 126 |
| Annual membership | 20 |
| Transport/storage | 19 |
| Home office | 10 |
| Other | 13 |
| Total expenses | 188 |
| Total revenue | 253 |
| Profit | 66 |

Source: Deloitte Access Economics

In 2012 \$146 million was paid directly from ISPs to DSOs, through cost of goods sold and payments for annual membership.

4.3 Direct employment contribution

In 2012, DSOs spent an average of \$68,610 in wages per full time equivalent (FTE) employee. This is somewhat higher than the Wholesale Trade industry, where average annual full time earnings in 2012-13 were around \$56,000. From **Error! Reference source not found.** above, in 2012 DSOs paid \$104 million in wages, which implies 1,514 FTEs were employed directly by DSOs.

Additional to this is the employment generated through the working ISPs. As there is a large share of ISPs that purchase goods from DSOs for their own personal consumption, the ISP survey was divided into those who participate in the industry to make money, and those who buy the goods from the DSO with no intention of reselling. This led to an average profit, for working ISPs, of \$12.25 per hour which implies around \$23,954 per year for a FTE ISP. The industry wide ISP profits were \$66 million. In 2012 there were a total of 4,262 directly employed DSO employees and ISPs.

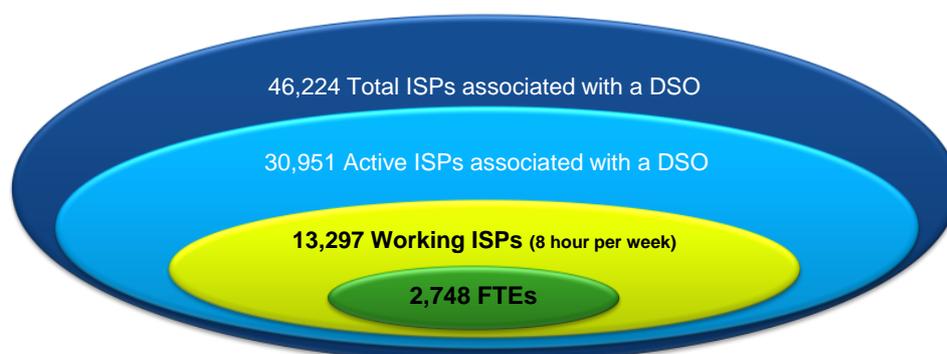
Table 4.5: Direct employment from direct selling, New Zealand 2012

| | |
|-----------------------------|---------------|
| DSO Wages | \$104 million |
| Annual labour cost per FTE | \$68,610 |
| DSO FTEs | 1,514 |
| ISP profits | \$66 million |
| Profit/hour | \$12.28 |
| Effective annual FTE salary | \$23,954 |
| ISP FTEs | 2,748 |
| Total FTEs | 4,262 |

Source: Deloitte Access Economics calculations Note: FTE works 37.5 hours per week.

At the end of 2012, the DSO surveys suggest there were over 46,000 ISPs associated with a DSO, of which 31,000 were active. However, many of these active ISPs purchase the goods for their own consumption and don't work any hours during the week. There are 2,748 FTE ISPs that work 37.5 hours a week. Using the eight hour per week survey average, we conclude there are over 13,000 ISPs working.

Chart 4.5: ISPs in the New Zealand Direct Selling Industry, 2012



Source: Deloitte Access Economics calculations

Active ISPs are defined as ISPs who made a sale in the last three months. The average ISPs works around 7.75 hours each week. The working ISPs figure is estimated using this average applying the appropriate ratio to find the amount of working ISPs per FTE.

4.4 Value added by the direct selling industry

In 2012, the direct selling industry generated \$170 million of direct value added. Of this, \$66 million (39%) came from the mixed income ISPs received; \$104 million was paid in wages to those employed by the DSOs, and a little over \$400,000 were profits for the DSOs (**Error! Reference source not found.**).

Table 4.6: Direct value added by DSOs and ISPs, 2012

| Direct value added | \$ million |
|---------------------------------|------------|
| DSO | |
| GOS | 0.4 |
| Wages | 104 |
| ISP | |
| Mixed income | 66 |
| Direct value added (\$ million) | 170 |
| Direct employment (# FTE) | 4,262 |

Source: Deloitte Access Economics calculations

In 2012, \$84 million was spent on intermediate goods; around 80% of these goods were imported from overseas. DSOs also paid a total of \$20 million in rent, transport & storage, financing, and other overheads. ISPs spend \$41 million on intermediate inputs, mainly on transport & storage.

Table 4.7: Intermediate inputs used by DSOs and ISPs, 2012

| Intermediate inputs | \$ million |
|-------------------------|------------|
| DSO Intermediate inputs | |
| COGS (domestic) | 4 |
| COGS (international) | 19 |
| Overheads | 20 |
| ISP Intermediate inputs | |
| Transport & storage | 19 |
| Home office | 10 |
| Other | 12 |
| Total | 84 |

Source: Deloitte Access Economics calculations

In 2012, the \$84 million expenditure on intermediate inputs by the direct selling industry contributed \$56 million in flow-on contributions to the rest of the economy and generated 380 positions (Table 4.8).⁷

Other industries benefit through additional employment and gross output. The Transport support services and Storage sector benefits the most with 186 FTEs created and an additional \$37 million worth of output. The Auxiliary finance and insurance services sector gained 19 FTEs and \$4 million worth of addition output, while the electricity transmission and distribution sector gained 9 FTEs and \$5 million worth of addition output.

Table 4.8: Indirect contributions from intermediate inputs, 2012

| Indirect Contribution | |
|--------------------------|-----|
| Value added (\$ million) | 56 |
| Employment (FTE) | 380 |

Source: Deloitte Access Economics calculations

4.4.1 Total economic contribution

The direct selling industry makes a significant contribution to the New Zealand economy. The economic contribution of the industry to New Zealand is estimated to be \$226 million in 2012.

As part of its economic contribution, the direct selling industry supports employment in the New Zealand economy. Around 4,260 FTE jobs are directly employed in the industry with a further 380 employed indirectly.

⁷ Input output tables are used to account for the flow of intermediate goods from the direct selling industry towards other parts of the economy.

Table 4.9: Total Economic contribution of the Direct Selling Industry, 2012

| Total contribution | |
|---------------------------|-------|
| Value added (\$ million) | 226 |
| Employment (FTE) | 4,642 |

Source: Deloitte Access Economics calculations

The size and scope of the direct selling industry in New Zealand is greater than the estimated dimensions presented in this report. Therefore, this estimate is a conservative estimate of the actual economic contribution of the direct selling industry. Nonetheless, it indicates that direct selling is a significant part of the retail landscape.

4.4.2 Links to the community

Just over half of the survey respondents stated that they made charitable donations. All respondents indicated donations were less than 1% of total revenue. Anecdotally, e.g. DSO websites suggest that DSOs are more active than this.

Figure 4.2: Case study

The Avon Breast Cancer Crusade

The Avon Breast Cancer Crusade was launched in Australia and New Zealand in 1996 to raise funds for and increase awareness of breast cancer. The crusade supported by Avon in more than 50 countries around the world.

More than \$10 million has been raised in New Zealand and Australia and from the sale of Pink Ribbon products.

In New Zealand Avon donates funds to the New Zealand Breast Cancer Foundation, a charitable trust that aims to educate women about breast cancer and the importance of early detection while working towards the goal of complete control of the disease.

Source: <http://www.avon.co.nz/PRSuite/crusade.page>

5 Challenges for the industry

The New Zealand retail industry is characterised by a range of sizes of business and retail format. Competition is driving change in the industry, the result of the rise of online retail activity and increased competition from foreign companies selling into New Zealand.

While the direct selling industry faces the same challenges as the broader retail industry there are a number of specific issues the direct selling industry is facing including regulation, public perceptions and demographic change and online retailing.

5.1 Public perceptions

There are negative reactions to the industry and persistence of negative stereotypes in the media and, perhaps, amongst government and regulators. Some issues have been dealt with by, e.g. introducing measures to prevent bad practices; others require a better evidence base to test the validity of views.

5.1.1 Pyramid selling

There is a perception amongst the public that direct selling is akin to pyramid selling. There was not consensus of this issue during consultations where it was both suggested that this perception was no longer held amongst the wider community and that it remained a concern for those involved in the industry.

One of the key aims of this report was to provide evidence which could help to shift this perception. The results of the ISP survey including high ISP satisfaction with remuneration, the average length of time in the industry and the high level of purchase for own use, suggest that there are long term employment opportunities within the direct selling industry.

Indeed, the survey of ISPs demonstrated that most (73%) ISPs do not manage a down-line, an indicator of a pre-requisite for pyramid selling. In light of this and in light of the primary benefit of the industry as viewed by ISPs was for their own consumption of goods suggests that pyramid selling is not an aspect of the direct selling industry.

5.1.2 High pressure selling

High pressure selling is an issue for customers and has been a focus of regulators too. In the case of a party plan, participants know and accept beforehand that a salesperson will be selling products at the event. If customers had a problem with high pressure selling two things would be expected: a high return of product rate; and a high number of complaints. However, almost all ISPs surveyed (83%) said they had not received a complaint in the last 12 months. Further, of those that have received complaints, almost half of the complaints related to product quality and a further 20% related to delivery times. This suggests that it is not high pressure selling per se that affects customers. Nonetheless, given the recent regulatory focus of these issues it is important for the industry to continue to address these perceptions.

5.2 Demographic change

As New Zealand's ageing population moves towards retirement there are a few key issues that participants in the direct selling industry should consider.

The direct selling industry is often perceived as an activity for older generations. However, section 3.1.1 above shows that about one quarter of people involved in the industry are less than 35 years old and around half of the ISPs and sellers are between 36 and 55 years old.

With the ageing demography of the population in general issues of succession will affect direct selling as they affect other business. One of the differentiating features of direct selling is that it is possible to earn income from a downline well into retirement years. The structure of fees and commissions payable in the industry mean that ISPs who are no longer actively involved in the industry are still able to earn income through their downline, thus providing ongoing income through retirement.

5.3 Online retail

The online retailing environment is having an increasing effect on direct selling as well as the traditional 'bricks and mortar' models. Online retailing offers a wider range of consumer options at a low cost and convenience. Recent issues for the overall retail industry that have been caused by this include GST not applying to goods purchased online from overseas. The rise of online retail was highlighted as a key threat from the surveys.

The connections between the different direct selling retail models are likely to have been hastened by the growing importance of the internet for the New Zealand retail industry. Increasingly, sales made via the internet present both challenges and opportunities for the direct selling industry.

For example one of the DSOs consulted has embraced an online system for marketing to their customers. This entails gathering email addresses from customers which are linked to consultants – this gives consultants another avenue to follow up with their customers, by phone.

5.3.1 Interactions with customers

There was varying degrees of interaction between the DSO's and their customers; some will deliver only to the ISP while others will deliver directly to the consumer. Consultations indicated that for some DSOs and ISPs this was a much easier and cost effective process for their consultant. Online and digital communication will change the way that DSOs and ISPs interact with their customers.

The demographics of those who are more likely to use the internet, compared to the demographics of the traditional direct selling consumer are seen as a major challenge for the industry. Online retail buying has largely been taken up Generations X and Y, rather than older generations. Adapting direct selling to the preferences of younger generations is a key challenge for the industry. But the survey suggests these concerns may be overstated.

At the same time, there are considerable opportunities from the on-line retail environment. Internet sales by ISPs may have an advantage due to superior product knowledge and where they are known to the consumer, consumer trust and after sales service; the overriding driver is personal relationships.

5.3.2 Adapting to change

The ability to stay ahead of technological change was noted in the DSO survey as important to remaining a viable alternative. Indeed, one respondent noted that as consumers become more time poor, there is likely to be a shift away from traditional direct selling methods, such as party plan, towards online.

6 Conclusions

The direct selling industry is an important component of the broader retail industry. The industry directly and indirectly employs almost 4,700 people. However, despite the significant role that the sector plays in the industry, there remain a number of issues that need to be addressed.

6.1 Key messages

Direct selling makes an important socioeconomic contribution to the New Zealand economy.

- By providing a flexible working option the direct selling industry increases workforce participation and boosts productivity and equity in the New Zealand economy.
- Direct selling is an important alternative to traditional 'bricks and mortar' retailing, providing competition, innovation and a wider choice of retail options to consumers.
- There are clear social benefits including providing additional income to individuals earning low incomes, promoting self-confidence for those involved in the industry and encouraging social interaction.
- Criticisms of the industry are not supported by the evidence. That said, the evidence base for the industry is patchy and requires more research.
- There are a number of challenges that the industry will need to address including responding to demographic change as the direct selling salesforce moves towards retirement, understanding how the industry can best respond to technological change and digital disruption and responding to negative public perceptions that exist in pockets of the community.

6.2 Outstanding issues and areas for future research

6.2.1 Response to survey

While a number DSOs completed the survey they represent only part of the industry in New Zealand, further the extent to which the questions were answered varied. There was a significant ISP response to the survey. However, there was concentration of responses around certain DSOs. Increased response rates will provide more confidence in results and allow for granular analysis; e.g. at the product level.

6.2.2 True size of industry

The economic contribution outlined above only includes DSOs and their ISPs who are members of the DSANZ. Estimates do not include international based and private companies which are non-members of the DSANZ and therefore may not provide information on their activities in New Zealand. (Note: total DSO revenue figures from the

client for Member plus Non Member could be used to determine national totals. Assuming non-member DSOs and their ISPs follow the same cost and revenue distribution, we could determine an industry value using \$293 million, instead of \$253 million).

6.2.3 Data

Obtaining official data which compares the level of complaints across the broader New Zealand retail industry as distinct from the direct selling industry is challenging.

6.2.4 Areas for future research

An economic impact analysis of the direct selling industry begins with a baseline 'business as usual' estimate. From this baseline it is possible to estimate the impact of different policy scenarios for a range of aggregates such as sales level or employment impacts within the industry. Possible policy scenarios which can be modelled include an increase in the labour supply as a result to the increased labour force flexibility provided by the sector.

Future research could help to understand the impact, including the size of the impact, that some of the challenges outlined in section 5 above may have on the industry.

Appendix A: Surveys

The broad themes that were used to aid understanding of the industry were also employed to design the surveys. As such, the surveys were structured as follows:

Themes for the survey of DSOs:

1. **Nature of the business – how does your firm fit into the retail landscape?** The aim of these questions was to place direct selling in the broader retail landscape. Many people do not understand or are distrustful of direct selling. There are a range of sales channels and sales techniques available to retailers, so it is important to be able to explain how direct selling has a legitimate role to play.
2. **Financials – what is your bottom line and how do you get there?** The aim of this question was twofold; 1) to profile the industry by obtaining financial and other information necessary for estimating the economic contribution of direct selling in Australia and New Zealand; and, 2) to test negative perceptions of DSOs taking advantage of ISPs, e.g. high turnover, pyramid selling.
3. **Sales force – what is your relationship with the people who sell your product?** The aim of this question was to understand the working relationship between the DSOs and ISPs. Like all businesses, DSOs must engage, support and retain ISPs.
4. **Customers – what is your relationship with the people who buy your product?** The aim of this question was to understand who is purchasing the products and what motivates them to purchase goods via direct selling.
5. **Regulation and other issues – what other factors affect the success of your business?** This question aimed to establish what effect the current regulations have had on direct selling and what potential changes or improvements could be made.

Themes for the survey of ISPs:

1. **Demography – who are you?** The aim of this question was to understand the demographic profile of ISPs in the direct selling industry. This was useful in demonstrating the role of the direct selling industry in allowing discouraged/detached people to earn additional income, highlighting the direct selling industry as a “kindergarten” for small business owners and as a means for people who would not otherwise participate in paid employment.
2. **Effort – how much effort do you put into direct selling?** This question enabled us to estimation of per hour earnings of sellers in the direct selling industry. This also helped us to understand the extent that direct sellers are involved in the industry, for example, is direct selling part-time employment to earn supplementary income.
3. **Participation – why are you involved in direct selling?** The aim of this question was to understand the motivation for direct sellers to participate in the industry. This enabled us to highlight where the direct selling industry sits in terms of advantages of direct selling relative to paid employment.

4. **Financials – what are your income and expenses?** The aim of this question was to provide input into the economic contribution and as a cross reference to the financial responses provided by DSOs.
5. **Benefits – what are the non-financial rewards of direct selling?** The aim of this question was to highlight the key social impacts of the direct selling industry.
6. **Customers - what is your relationship with the people who buy your product?** This question addressed some of the criticisms of the industry such as high pressure selling. This question also highlighted how online retailing is changing nature of the direct selling industry and how ISPs interact with customers.

DTermine

The survey development would be conducted by Deloitte's survey and benchmarking platform, DTermine™, providing managed hosting, deployment and reporting of existing or tailored online surveys to a nominated set of respondents.

Features include:

- Custom built surveys with exceptional flexibility allowing complex questions, routing, validation and multi-lingual support.
- Integrated user IDs which allow partly completed surveys to be saved and returned to later – even for anonymous surveys.
- Authentication of users against a unique id, user name or email address and password if require.
- True anonymity where required, in the sense that no personal information is gathered unless specifically stated.
- 24/7 in-house support.
- Professional quality assurance of survey and report design.

Survey questions

The two surveys undertaken were organised into a number of themes, outlined in detail above.

Appendix B: Economic contribution studies

Contribution – the general approach

Economic contribution studies are intended to quantify measures such as value added, exports, imports and employment associated with a given industry or firm, in a historical reference year. The economic contribution is a measure of the value of production by a firm or industry.

Value added

Value added is the most appropriate measure of an industry's/company's economic contribution to gross domestic product (GDP) at the national level, or gross state product (GSP) at the state level.

The value added of each industry in the value chain can be added without the risk of double counting across industries caused by including the value added by other industries earlier in the production chain.

Other measures, such as total revenue or total exports, may be easier to estimate than value added but they 'double count'. That is, they overstate the contribution of a company to economic activity because they include, for example, the value added by external firms supplying inputs or the value added by other industries.

Measuring the economic contribution

There are several commonly used measures of economic activity, each of which describes a different aspect of an industry's economic contribution:

- **Value added** measures the value of output (i.e. goods and services) generated by the entity's factors of production (i.e. labour and capital) as measured in the income to those factors of production. The sum of value added across all entities in the economy equals gross domestic product. Given the relationship to GDP, the value added measure can be thought of as the increased contribution to welfare.

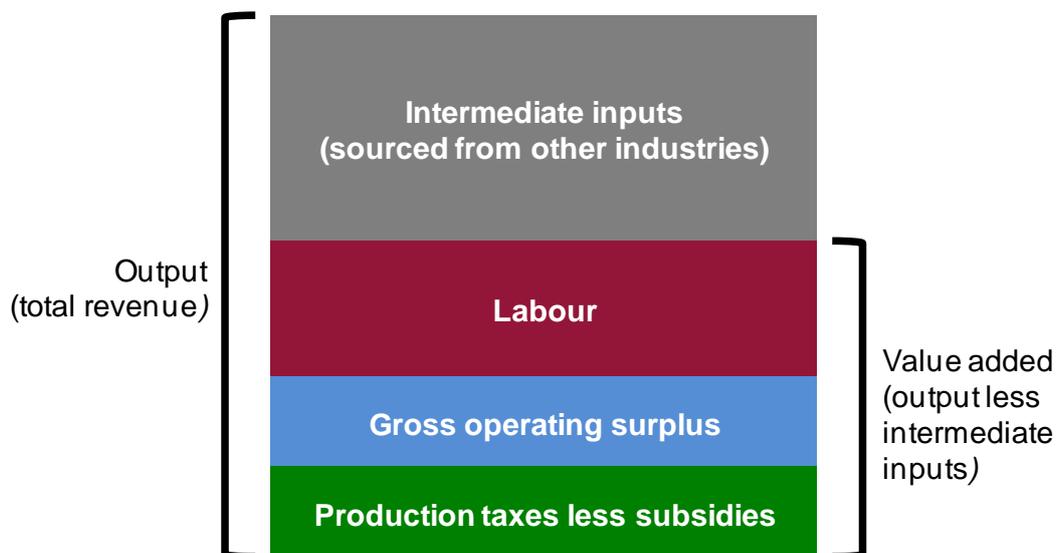
Value added is the sum of:

- Gross operating surplus (GOS). GOS represents the value of income generated by the entity's direct capital inputs, generally measured as the earnings before interest, tax, depreciation and amortisation (EBITDA).
- Tax on production less subsidy provided for production. This generally includes company taxes and taxes on employment. Note: given the returns to capital before tax (EBITDA) are calculated, company tax is not included or this would double count that tax.

- Labour income is a subcomponent of value added. It represents the value of output generated by the entity's direct labour inputs, as measured by the income to labour.
- **Gross output** measures the total value of the goods and services supplied by the entity. This is a broader measure than value added because it is an addition to the value added generated by the entity. It also includes the value of intermediate inputs used by the entity that flow from value added generated by other entities.
- **Employment** is a fundamentally different measure of activity to those above. It measures the number of workers that are employed by the entity, rather than the value of the workers' output.

Figure B.1 shows the accounting framework used to evaluate economic activity, along with the components that make up gross output. Gross output is the sum of value added and the value of intermediate inputs. Value added can be calculated directly by summing the payments to the primary factors of production, labour (i.e. salaries) and capital (i.e. gross operating surplus (GOS), or profit), as well as production taxes less subsidies. The value of intermediate inputs can also be calculated directly by summing up expenses related to non-primary factor inputs.

Figure B.1: Economic activity accounting framework



Source: Deloitte Access Economics.

Direct and indirect contributions

The **direct** economic contribution is a representation of the flow from labour and capital in the company.

The **indirect** contribution is a measure of the demand for goods and services produced in other sectors as a result of demand generated by the Direct Selling Industry. Estimation of the indirect economic contribution is undertaken in an input-output (IO) framework using Statistics New Zealand's input-output tables which report the inputs and outputs of specific sectors of the economy (Statistics New Zealand, 2007).

The total economic contribution to the economy is the sum of the direct and indirect economic contributions.

Limitations of economic contribution studies

While describing the geographic origin of production inputs may be a guide to a firm's linkages with the local economy, it should be recognised that these are the type of normal industry linkages that characterise all economic activities.

Unless there is significant unused capacity in the economy (such as unemployed labour) there is only a weak relationship between a firm's economic contribution as measured by value added (or other static aggregates) and the welfare or living standard of the community. Indeed, the use of labour and capital by demand created from the industry comes at an opportunity cost as it may reduce the amount of resources available to spend on other economic activities.

This is not to say that the economic contribution, including employment, is not important. As stated by the Productivity Commission in the context of Australia's gambling industries:⁸

Value added, trade and job creation arguments need to be considered in the context of the economy as a whole ... income from trade uses real resources, which could have been employed to generate benefits elsewhere. These arguments do not mean that jobs, trade and activity are unimportant in an economy. To the contrary they are critical to people's well-being. However, any particular industry's contribution to these benefits is much smaller than might at first be thought, because substitute industries could produce similar, though not equal gains.

In a fundamental sense, economic contribution studies are accounting exercises. No 'what-if', or counterfactual inferences – such as 'what would happen to living standards if the firm disappeared?' – should be drawn from them.

The analysis – as discussed in the report – relies on a national input-output table modelling framework and there are some limitations to this modelling framework.

The IO framework and the derivation of the multipliers applied assume that the relevant economic activity takes place within an unconstrained environment. That is, an increase in economic activity in one area of the economy does not increase prices and subsequently crowd out economic activity in another area of the economy. As a result, the modelled total and indirect contribution can be regarded as an upper-bound estimate of the contribution made by the supply of intermediate inputs.

Similarly the IO framework does not account for further flow-on benefits as captured in a more dynamic modelling environment like a CGE model.

⁸ Productivity Commission (1999), *Australia's Gambling Industries*, Report No. 10, AusInfo, Canberra, (page 4.19).

Input-output analysis

Input-output tables are required to account for the intermediate flows between sectors. These tables measure the direct economic activity of every sector in the economy at the national level. Importantly, these tables allow intermediate inputs to be further broken down by source. These detailed intermediate flows can be used to derive the total change in economic activity associated with a given direct change in activity for a given sector.

A widely used measure of the spill-over of activity from one sector to another is captured by the ratio of the total to direct change in economic activity. The resulting estimate is typically referred to as 'the multiplier'. A multiplier greater than one implies some indirect activity, with higher multipliers indicating relatively larger indirect and total activity flowing from a given level of direct activity.

Appendix C: Direct selling organisations

DSANZ members

- Agel International
- ACN Pacific Pty Ltd
- Aim New Zealand
- Alpha Bio-Tech New Zealand Ltd
- Amway of New Zealand
- Atise Limited
- Avon Cosmetics New Zealand Ltd
- Biopro Technology Australasia
- Emma Page Jewellery
- Enagic Australia Pty Ltd
- ENJO New Zealand Ltd
- Esteem Jewellery Ltd
- Flo2cash Limited
- Freelif International Australia Pty Ltd
- GNLD International New Zealand
- Herbalife (NZ) Ltd
- Home Direct Ltd
- Homecare Direct Shopping Ltd
- Intimo Lingerie
- Lê Reve New Zealand Ltd
- Lifeforce Australasia Pty Ltd
- 4life
- Lux Sales and Service
- Mannatech New Zealand
- Mary Kay Cosmetics Ltd
- Natures Sunshine Products (NZ) Ltd
- New Image International Ltd
- Neways International (NZ) Ltd
- Niagara Healthcare (NZ) Ltd
- Nikken
- Nu Skin (NZ) Inc (NSE)
- Nutrimerics International (NZ) Ltd

- Pro-Ma Systems (NZ) Ltd
- Phoenix Trading Ltd
- Reliv New Zealand
- Simpson Grierson
- STEMtech New Zealand Ltd
- Tahitian Noni International NZ Limited
- Totally Organised Ltd
- Undercoverwear Lingerie Parties
- USANA New Zealand Limited
- World Organic Ltd

Appendix D: Literature review and other references:

Peterson, RA and Wotruba, TR 1996, 'What is direct selling? Definitions, perspectives and research agenda', *The Journal of Personal Selling and Management*, 16(4):1-16.

Peterson and Wotruba outline three perspectives of direct selling which provide a framework for defining the industry.

- **Operational perspective:** The operational perspective encompasses two major elements, 'face-to-face selling' that is 'away from a fixed location', two important features of direct selling which differentiates this method from traditional retail selling. Firstly, direct selling is akin to relationship marketing, where relationships between buyers and sellers are promulgated and maintained over periods of time. Secondly, this perspective highlights the different location characteristic of direct selling; it is non-retail store retailing that takes place outside traditional retail locations.
- **Tactical perspective:** The operational perspective of direct selling presents a straight forward buyer-seller relationship. In practice however, the different characteristics of direct selling organisations and independent sales people (ISP) have implications for both the selling and recruiting tactics employed. Direct selling can be characterised by:
 - the relationship between the direct selling organisation (DSO) and the sales people;
 - the type of sales person;
 - whether selling agents are part-time or full time;
 - whether the selling effort occurs in a home or elsewhere;
 - whether it is a transaction-oriented or relationship-oriented;
 - whether it follows a party plan format;
 - whether pre-notification is used;
 - whether compensation is multi-level;
 - the extent to which selling agents are also customers;
 - whether selling agents take physical possession of products; and
 - the manner in which purchases are delivered to customers and payment is obtained from customers.
- **Strategic perspective:** From the strategic perspective direct selling can be viewed as a way of organising sales and selling activities. Direct selling is a channel or mode of distribution for retail goods, a method for gaining access to a market, or a way of doing business.

DSAA and Russell Kennedy 2012, 'Legal compliance and risk management guide for members of the direct selling association of Australia'.

There are two main models of the relationship between a DSO and an ISP.

Buy-resell model

Under the buy-resell model the DSO sells goods to the ISP at the DSO's wholesale price. The ISP is then authorised to re-sell to the retail consumer, at a retail price that they choose (there are recommended retail prices, but the final price is at the discretion of the ISP). The income earned by the ISP is the margin between the wholesale purchase price and the retail price (which is usually set according to the DSO recommendation), *plus* any commissions or bonuses payable under the DSO's compensation plan, *less* any costs incurred in selling (such as hosting the party or associated travel).

Commission-agency model

The DSO appoints the ISP to act as an independent facilitator of the sale of goods or services, with the transaction taking place between the DSO and the retail consumer. For example, an ISP will sell a product to a consumer and the DSO will then deliver the product to the customer without the ISP gaining legal title over the goods. Income earned by the ISP consists of the commission on the retail sale plus any other commissions or bonuses payable under the applicable compensation.

Direct selling organisations in Australia and New Zealand operate according to one or more business methods:

- party plan;
- network marketing; and
- door-to-door / catalogue (direct marketing).

Party plan is the most well-known direct selling model, where the parties are used to generate sales of goods and services. Generally a prospective purchaser is invited to the home, workplace, or other setting by a host (who is not the ISP), with products then demonstrated by the ISP and sold to participants. Subsequent purchase of goods online is not uncommon with this method of direct selling.

Network marketing is a process in which ISPs will establish and maintain relationships that result in the sale of products. These relationships are not confined to a home or workplace and introductions may be solicited or unsolicited. There is a tiered compensation structure for ISP's involved in network marketing; ISP's earn income through the sale of products and as a percentage of sales for ISP's who they have 'sponsored' (trained and recruited). The tiered structure can sometimes be across several levels.

Door-to-door / catalogue is the process where cold canvassers doorknock prospective consumers. This may involve the ISP delivering and picking up catalogues without any interaction with the consumers, and physical contact between the ISP and consumer might not take place until delivery of the product. Unlike the other direct selling methods door-to-door selling involves little, if any, recruitment activity by ISP's.

Monash University 2010, 'DSAA Industry Metrics'.

Previous analysis by the DSAA has highlighted the motivations for ISPs to be involved in the direct selling industry in Australia. More than half of the ISPs surveyed by the Monash University team indicated that personal consumption was one of the reasons for membership to their DSO. The low risk entry into the market and the ongoing business support offered by the DSOs was another primary motivating factor for ISPs.

The changing composition of the Australian workforce has had an impact on the direct selling industry. In particular, the increasing participation of women in the workforce is affecting the nature of participation in the direct selling industry by women. Evolving consumption patterns mean that dual income homes are becoming the norm, and the income earned by participants in the direct selling industry is evolving to reflect this. Previously an ISP may have joined the industry for a discrete period of time to earn income for a specific purchase. However, to sustain a continuous second income flow an ISP will need to be more actively, and continuously, involved in the industry.

The flexibility of the industry to adapt to these changes, relative to traditional bricks and mortar retail, is demonstrated by the significant proportion of their sales are facilitated through the Internet.

Brodie, S, Albaum, G, Der-Fa RC *et al* 2004, 'Public perceptions of direct selling: an international perspective', Westminster Business School Research Report

In a survey of eight countries (including Australia) Brodie *et al* (2004) found that the primary motivating factor of retail consumers to purchase products through the direct selling retail channel is convenience, product need and appeal. Value for money and the service provided were also cited as important motivating factors. From the global sample, social obligation and image of direct seller were the least cited reasons for purchase by consumers.

DSAA 2007, 'Economic study and demographic profile of the direct selling industry in Australia'

The DSAA estimates there are around half a million ISPs in Australia. ISPs participate in a range of activities. The level of involvement in the industry depends on the range of activities an individual chooses to participate in.

- An ISP may participate in personal selling activities.
- An ISP may become involved in the industry to acquire products at wholesale prices, becoming consumers of the goods in their own right.
- An ISP may actively recruit, train and manage a 'down line' of other ISPs using network marketing techniques, as well as undertaking their own personal selling activities.

The 2007 economic study of the industry undertaken for the DSAA found that sellers were more likely to be female, aged between 30-50 years, and earning less than \$1,000 from direct selling activities throughout the year.

Productivity Commission 2011, 'Economic Structure and Performance of the Australian Retail Industry', Report no. 56, Canberra.

The regulatory environment faced by the direct selling industry is distinct in some ways from the general retail environment. As outlined by the Productivity Commission (2011), specific issues arising from the Australian Consumer Law (ACL) for the direct selling industry include:

- poor design imposing unnecessary cost in attempting to achieve underlying consumer protection objectives;
- unduly prescriptive, uncertain, biased and ill targeted;
- restricting competition and consumer choice, and
- non-compliance with regulatory development standards.

The Productivity Commission also notes that for the broader Australian retail industry, the requirements of the ACL have increased compliance costs for many retail businesses.

The online retailing environment has also begun to have an effect on the more traditional 'bricks and mortar' and direct selling retail environments. Online retailing offers a wider range of consumer options at a low cost and convenience. Recent issues for the industry that have been caused by this include, lower GST taxation revenue, and increased postal and customs costs. To promote equality of taxation, many retailers support a low value threshold exemption for GST and duty on imported goods to be lowered from \$1,000 (its current threshold). Currently, the Australian Competition and Consumer Commission (ACCC) is addressing issues of local retailers blocking online sales of international affiliates. How these issues have impacted, and will continue to impact, the direct selling industry is yet to be determined.

Thompson, K. 2009, 'Pyramid schemes: Saving the network marketing industry by defining the gray'.

In **pyramid selling** the intention is to recruit additional distributors who purchase products for themselves, rather than the selling of products to customers, who are independent of the DSO. More simply, a pyramid selling scheme is one in which income is earned from recruitment of additional members, rather than the legitimate sale of products.

A number of legal issues concerning direct selling being used as a pyramid scheme have been discussed in the United States. *A key issue for the courts has been the difficulty of distinguishing between legitimate network marketing companies and illegal pyramid schemes.*

The courts have found that certain safeguards can prevent organisations being deemed to be pyramid schemes. The 'Amway safeguards', were that sellers must sell to 10 customers a month and that 70% of products must be sold to bona fide customers.⁹ In other cases, courts have found that a tiered scheme, in which ISPs must make sales of 400 US dollars a month to five customers outside the network in order to obtain recruitment bonuses, was

⁹ *Amway*, 93 F.T.C. at 26.

sufficient evidence to indicate that the organisation was not conducting a pyramid scheme.¹⁰

However, although this arrangement helps ensure that the product is sellable and that ISPs are engaged in selling to those outside the network, as more individuals are recruited the incentives to focus on recruitment will increase. Whether this is a concern ultimately depends on the extent to which purchases by recruits are converted into retail sales and will differ depending on the precise incentives in each multi-level remuneration scheme. Thomson noted that in some cases sales to non-participants constituted less than 5% of total sales. *Thus, the key metric for identifying the existence of pyramid schemes is the extent of sales to non-participants.*

Williams, S 2009, 'Give it a go: What have you got to lose?'

'Give it a go: What have you got to lose?' is a guide for perspective ISP's. The book outlines the attributes of the three direct selling methods to assist perspective ISP's selecting the right selling method for them, the advantages and rewards of being involved in the direct selling industry, and outlines methods for success. A summary of the key points is provided below.

Certain products are suited to direct selling – rather than the broader retail industry – while other products are suited to certain direct selling methods. For example, fashion products are suited to party plan, and weight loss products are suited to network marketing.

There are a number of advantages for ISP's to be involved in the direct selling industry:

- Supplementary income;
- Flexibility around work hours;
- An entry point for start-up small business owners;
- Confidence;
- Friendship;
- Personal and professional development.

The challenges faced by ISP's in the direct selling industry are primarily issues working in a sole employee business such as managing your own time management problems of isolation and additional administration tasks. The possibility of negative attitudes of friends and family was also highlighted as a challenge for ISP's.

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¹⁰ *Order, The Secretary of State for Business Enterprise and Regulatory Reform v. Amway (UK) Limited, Nos. 2651, Australian Bureau of Statistics, 2013, 'Retail Trade, Australia'. Cat No. 8501.0 2652 and 2653 at ¶ 57(b).*

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