

## **STRUCTURE AND FUNCTIONING OF DIRECT MARKETING SYSTEMS**

**IOAN NICOLAE TIUZBAIAN,  
LAVINIA HULEA \***

**ABSTRACT:** *The system of direct marketing might be defined as follows: “A method for selling goods directly to consumers through a network developed by independent distributors, who, at their turn, introduce other distributors, the income resulting from the profit of retail sales and wholesales, to which rewards based on the total sales of the group built by each distributor added. In accordance with Deakins, an entrepreneur is the individual who owns the commitment and ability to assume reasonable risks with a view to succeed in business. The legal form of collaboration is, mainly, a collaboration contract between a legal person (the direct marketing company) and a natural person (the distributor). As a rule, the distributor carries out the activity based on a simple authorization in the field of marketing; nonetheless, there is also the option for the distributor to work based on one of the forms of legal entities operating in each country. The Abstract will only be in English and will have between 100 and 150 words, a single, left-right alignment,*

**KEY WORDS:** *direct marketing, consumers, independent distributors, profit, rewards, entrepreneur, business.*

**JEL CLASSIFICATIONS:** *D22, D30, M39.*

### **1. DEFINING DIRECT MARKETING**

Further, we are going to show the operating principles of the systems of direct marketing. The manner according to which these marketing systems should operate represents one of the main management topics in the field of direct sales.

From a management point of view, we should consider the difference between the manner of administering a company (where the manager is an entrepreneur) and the

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\* Lecturer, Ph.D., University of Petroșani, Romania, [tiuzbaian@yahoo.com](mailto:tiuzbaian@yahoo.com)

Lecturer, Ph.D., University of Petroșani, Romania, [laviniahulea@yahoo.com](mailto:laviniahulea@yahoo.com)

manner of administering one's own business (where the owner of the business is an *intrapreneur*).

In accordance with Deakins, *an entrepreneur is the individual who owns the commitment and ability to assume reasonable risks with a view to succeed in business*. An entrepreneur plays the following five important management roles:

1. *Intermediary* – gathers the data required for implementing the opportunity of a lucrative business;
2. *Original* – discovers the sources displaying the potential of the business opportunity chosen;
3. *Innovator* – adopts new development technologies, while competing with other companies;
4. *Risk supervisor* – assumes bearable risks in order to reach profit;
5. *Coordinator* – administers resources, accumulated capital and adapts the system to the changes within the economic environment.

Furthermore, in accordance to Carrier, an intrapreneur is the person who is willing to assume responsibility with a view to carry out the tasks received from an entrepreneur. He/she displays the following 3 important features within the system:

1. An intrapreneur – develops the opportunity offered by entrepreneurs, through creating subsystems;
2. He/she is a distributor – helping the distribution of products and services or acquiring work methods and professional competence;
3. He/she is a sponsor – coordinating the activity of his/her work team through acknowledging values and developing a marketing network.

With a view to understanding the operating mode of the system of direct marketing, we are going to analyze the main activities carried out within these systems, at the interface between distributor and company:

- Sponsorship
- Legal collaboration
- Direct sale or recommendation
- Product distribution
- Sale price
- Training

### **1.1. Sponsorship**

The term sponsorship comes from the activity of recruiting and coordinating new distributors. Besides, the term emphasizes the liability of the sponsor for the new distributor in terms of providing the required support for training for the activity of direct sales.

Whenever somebody is *sponsored*, it means that this person wanted to enter the business in his/her own interest, after having signed a contract with a company whose products he/she is going to distribute.

The sponsor (mentor or coordinator) is either a distributor who already works in the business or a person who introduced the company and the opportunity to

collaborate with it, or a person nominated by the company as sponsor as a result of the sponsored individual addressing directly to the company.

The term “sponsor” is used with the following meaning: “*someone who, by his/her own will, becomes responsible for someone else*”. Let’s not mistake the sense of the word with the widespread meaning of offering someone an amount of money with a view to getting an advantage. In direct marketing, through sponsorship, they give *consultancy* and *know-how* to a person willing to collaborate with the sponsor in order to carry out a joint business.

Sponsorship is considered the essence of the success of developing a business in the field of direct marketing networks. Direct sponsors (together with the “ascending line of sponsorship”) benefit from the success of the new distributor owing to the fact that the number of direct sales made by this one also determines a commission for the sponsor. In other words, *through sponsorship, training in exchange for performance is offered*.

## 1.2. Legal collaboration

As we are talking about a collaboration between the elements of the systems of direct marketing, the connection between the company and the distributors occurs through a mutual commitment, without the constraint of a contract of employment. This is essential for direct marketing and should be stressed from the beginning. There are *no employed distributors* in this field, *but collaborators of the direct marketing company*.

The legal form of collaboration is, mainly, a collaboration contract between a legal person (the direct marketing company) and a natural person (the distributor). As a rule, the distributor carries out the activity based on a simple authorization in the field of marketing; nonetheless, there is also the option for the distributor to work based on one of the forms of legal entities operating in each country.

When a person is registered as distributor, he/she should fill-in an application for membership in the direct marketing system specified, in accordance to which collaboration occurs. The registration is usually made without any fees; nonetheless, certain companies require a formal registration fee, which, most of the time, includes the cost of a full set of documents: a small guide, a magazine or a newsletter, data about the products, order forms, business recommendations and, sometimes, samples of products. The contract also compels the company to provide products, to give commissions and to offer those services which were included within the sales plan and documentation, so that the new distributor might be able to carry out his/her business as efficiently as possible.

In practical terms, the sponsored individual may stick to the level of a frequent consumer, in which case he/she is able to buy products at “wholesale” prices from the company. In such a case, the gains made by buying the products at a price that is much smaller than the retail price represents a saving for his/her own budget of about 20%.

In the case when the distributor wants to develop his/her own business, his/her gains will grow commensurate with his/her involvement in developing his/her own distributor network and the amount of the products sold.

### 1.3. Direct selling

Although the sales activity in its own has generated an industry, it should not be considered the most important activity in the system of direct marketing. We are going to see that training represents the key-activity of the MLM systems.

The first step to get a supplemental gain is the retail direct sale of the company's products. The profit that results from the retail sale prices goes to the distributor, who manages to earn a fair amount each month.

The sale methods vary and depend on: the type of products or services, the personal preferences of the distributor, the company's recommendations and a lot of other factors.

Although we are talking about direct sale, this activity should be considered in its entirety, with no analogy to travelling salesmen or bagmen. Direct selling does not only mean the act of delivering a product to a customer and to getting the money for it; direct selling means much more than this.

The main characteristics of direct selling are as follows:

- Choosing and selecting consumers (*market marketing*)
- Presentation of products (*primary consultancy*)
- Recommending the products (*determining the buying decision*)
- Selling (*distributing the products or filling-in the orders*)
- Customer satisfaction (*post-selling assistance*)

Let's also notice that the systems that do not use direct sale in the sense expressed above, but accumulate payments owing to recruiting clients are considered illegal pyramidal financial schemes. As only the movement of products from providers to consumers determines added value, all other forms of capital gathering, without transmitting

### 1.4. Product distribution

Products generally mean *physical objects* or *services* that are transmitted to clients in exchange of an amount of money. In other words, the client receives the *materialization of certain advantages* for his/her own benefit, for which he/she pays the settled *sale price*.

Due to this reason, specialized works talk about products, which include both physical products and services.

Under more general circumstances, we are able to talk about two categories of direct market systems, depending on the nature of the products distributed:

- I. Systems with commodity-products or *consumer goods*, which are directly distributed;
- II. Systems of services, indirectly distributed.

The difference between the two categories of systems is given by the stream of values between the provider and the customer, as follows:

- I. In the case when the MLM systems distribute commodity-products, the distributor buys from the provider and directly sales to the customer, while payments are directly received by the distributor;

- II. In the case when the MLM systems distribute services, the distributor recommends a product (service), while the provider directly delivers that service to the customer. The distributor does not receive directly any amount of money, but gets a commission for the completed recommendation.

### **1.5. Training**

The most important activity of direct marketing is, without any doubt, the training at all hierarchic levels of the system.

The management of training should include all the segments of the system:

- I. Organization chart
- II. Marketing network
- III. Associated subsystems

The objectives of training, at all levels, should meet the requirements of the MLM systems for continual development, under the circumstances of a permanent open competition occurring within a heterogeneous economic environment. Through the development of their integrated training programs, companies should focus upon:

- Winning professional competition;
- Improving work methods;
- Developing personality
- Stimulating labor efficiency
- Harmonizing activities

## **2. DEVELOPING A NETWORK**

The development of a sales network represents a means of getting important earnings in direct marketing. The efforts made with a view to building a structure for the distribution of the company's products will be rewarded by commissions, bonuses, discounts, copyright rewards and other direct incentives directly proportional with the sales generated by the distributors belonging to your own group.

The development of direct marketing networks is central within the management of direct sales companies.

### **2.1. Organizing a network**

The systems of direct marketing have introduced the notion of "doubling" or "multiplying" one's own efforts through the lever system so that, based on a low personal effort, one is able to get results equal to multiplied efforts. With this in view, the development and organizing of a personal direct sale structure should mainly aim at multiplying one's business through the distributors within the structure so that to be able to reach more consumers.

*Organizing a structure means fixing the elements of the structure in a manner enabling the reaching of its goals.*

From a psychological point of view, we may say that within a MLM network the personal satisfaction of the leader is shared with network distributors. The effect of this joint participation to the satisfaction of getting success represents the synergy of the group, which is a motivational catalyst for each individual in the group.

It is well-known that a direct marketing system is not a classical organization including employees depending on a director based on a contract of employment. A direct marketing system is a structure made of independent elements, connected by a company providing products through a collaboration contract.

The “pyramidal” management organization regards the setting of authority in a way that is characteristic for all administrative, economic, military or ecumenical structures. Unlike the “spherical” management organization, where authority is taken, successively, by the members of the organization, the pyramidal form of organization better enables the imposing and achieving of the goals settled by the initiator of the organization.

## **2.2. Forming networks**

The structures of the pyramid enable the organizing of its elements in two ways:

- I. On a single level of competences
- II. On several levels of competences

Starting from these possibilities, the companies of direct sales have adopted a proper form of organizing, namely either displaying a single level of distributors or several levels of distributors.

The evolution of direct sales has shown the advantage of pyramidal systems on several levels owing to the virtually endless activity multiplication possibilities.

In a structure on a single level of competence, distributors’ gains only represent one’s personal possibilities to carry out the activities of direct sale.

In a structure on several levels of competence, distributors’ gains come from two sources:

1. From one’s direct sales production
2. From the amount of the production of one’s structure

There are also other forms of reward as incentives from the company for exceptional results (bonuses, copyrights, royalties, etc.)

The distributor is able to develop a distribution structure on an infinite number of levels, in accordance with the marketing plan, while considering two basic rules:

1. *The potential of the structure is represented by its width*
2. *The stability of the structure is represented by its depth*

## **2.3. Profits and gains**

In direct marketing, profits and gains are always calculated in relation to the amount of the direct sales during a certain period of time.

Generally, the total amount of the commissions is divided by the company among the hierarchic performance levels settled according to a marketing plan.

*The sum of the differences among the levels should be equal with the total amount of the commissions, namely with the rewarding fund.*

The calculation of gains is made on the basis of the hierarchic position of each distributor (the career level), of the amount of personal production and on the amount of the production of one's own structure. Thereby, they calculate the difference between the level reached by the sponsor and the level reached by each of his/her distributors. This difference goes to the sponsor as a reward for his/her work for training his distributors.

#### **2.4. Reward system**

Besides the commissions gained each month, the distributor may benefit from other rewards depending on his/her performance. In practical terms, each distributor will go through the levels of a career in direct marketing, which should motivate and reward him/her for his/her work. The companies are compelled to plan a global system of rewards that might satisfy the expectations of the leaders of direct marketing systems owing to the fact that throughout the development of the structure the following questions might come out:

- *“What happens in the case when the network goes on growing?”*
- *“What happens when the first distribution level got in the situation of receiving a 45% discount, while this is the maximum available discount?”*
- *“Will the company lose the entire profit from wholesales?”*

When a maximum discount is reached, for instance in the case when the distributor attains, each month, a turnover of 5,000 USD, the calculation procedure of the commissions' changes. At this point, it is necessary a separate reward system because otherwise the whole business would become unmanageable due to the difficult record of merchandises and commissions given. Such a situation first occurred during the pioneering period of MLM systems, when the records of the structure were not computerized.

In order to reward the leaders' efforts, the companies have introduced a special procedure for calculating the commissions, which does not involve a reference to level differences.

As a result, in the case when a distributor reaches the same reward level on the scale of price discount as his/her sponsor, then he/she “breaks loose” from his/her sponsor and exists the calculations that generate the commissions according to level difference. The sponsor will get, from that time on, a bonus from the company, calculated as a percent from the total turnover of the distributor's group (substructure), namely 5% from 5,000 USD. This calculation procedure is called detachment and characterizes the marketing plans with “detachment levels.”

### 3. RODSA – ROMANIAN DIRECT SELLING ASSOCIATION

With a view to supporting the required regulations in the industry of direct selling in Romania, a group of founders has initiated, on April 15<sup>th</sup>, 2002, a professional association that includes all the companies in this industry.

RODSA or the *Romanian Direct Selling Association* has as founding members the following companies:

1. MLM International Romania SRL, a Romanian – German company, located in Cluj-Napoca, the only company in Romania that is specialized in distributing MLM books and training and improvement instruments;
2. Forever Living Products SRL, an America company, located in Bucharest, the largest company in the world that distributes products based on aloe vera, and
3. CARION Romania SA, a Romanian – Hungarian company, located in Cluj-Napoca, the largest European company that offers crediting services for cars and buildings.

RODSA is located in Cluj-Napoca, str. Ady Endre nr. 29, while its logo is in accordance with the logo of DSA in the U.S.A.

Its email address is the following one: [info@rodsa.ro](mailto:info@rodsa.ro) and its website may be accessed at: [www.rodsa.ro](http://www.rodsa.ro)

Besides the 3 founders, the association also includes affiliated members, observer-members, suppliers and leader-distributors. The direct sales companies located in Romania come from the field of insurances, health products, cosmetics and household products, etc.

The members of the association have mutually agreed upon the foundation and running this professional association with a view to introducing and observing a standard code of professional ethics for the members of the association and its affiliates that carry out their activity in the direct sales industry.

According to the vision of RODSA, direct selling represents the transmission or recommendation (promotion) of a consumer good (product or service) directly to the consumer, in locations that are not meant for retail, usually at the consumer's location, as a result of a demo or presentation performed by an independent distributor; this phrase may also be found in the content of Law 650/2002.

The association is open for all legal persons with their registered office in Romania, which carry out activities of direct selling, according to the legislation in force: trading companies, enterprises, firms, leader-distributors through their companies.

The members of the association admit that the legal persons involved in the direct selling industry should assume their liability to their customers owing to the manner of selling the products and services, from person to person or/and through networks of independent distributors, who should undertake observing these principles.

### 4. LEGIT MLM COMPANY, MLM LEGAL ASPECTS

The legislation, approved by the Romanian Government, sets forth the following aspects:

## a) The official definition of Direct Selling and Network Direct Selling

“ART. 35

*(1) Direct selling represents the trading practice enabling the trading of products and services directly to the consumers by the seller, apart from retail spaces, through direct sellers who present the products and services they offer for selling.*

*(2) Multilevel marketing is a form of direct selling through which the products and services are offered to consumers by means of a network of direct sellers who receive a commission both for their own sales and for the sales generated by the networks of direct sellers whom they personally recruited.”*

## b) Prohibited commercial practices

“ART. 36

*a) Pyramidal selling, a selling through the so-called “snowball” procedure or any other similar procedures that mainly consist in offering consumers products/services while making them believe they would either get these products free of charge or at a low price in comparison to the real value of the products/services, conditioning selling by placing tickets, coupons or other similar titles to be paid by third parties or by collecting adhesions or subscriptions;*

*b) Proposing a person to collect adhesions or to enlist, while making him/her hope for financial gains having resulted from the increase of the number of recruited or enlisted persons.*

ART. 37

*(1) In the case of the selling networks set up through recruiting adherents or affiliates it is forbidden to require the adherent or affiliate the payment of an amount for the right of entering the network, except for the price of formative-demonstrative pedagogical materials or services or of other similar materials or services.*

*(2) Within the same network, it is also forbidden to demand an adherent or affiliate the acquiring of a stock of products meant for subsequent selling, without the obligation asserting that the stock of products that was not sold by the adherent/affiliate is returned to the holder of the network.”*

When analyzing these articles, the following aspects stand out: a direct selling is made by means of the sellers who present their merchandise before their customers. Network direct selling is a multilevel selling. The sellers receive commissions for the products sold as well as for the sales generated by the networks of direct sellers whom they personally recruited. The problems come out in the circumstances displayed by art. 36 and 37, namely whenever the recruitment of new distributors is limitless and the emphasis is on recruitment and not on selling the products.

This aspect determines another issue: the probability that the total income of those involved in the MLM business originates from the recruitment of the new distributors. With this in view, in the case when a person ranks higher in the MLM plan that person gains from the sales of those whom he/she recruited as much or much more than the persons recruited earn from their own sales, then that person is motivated to go on recruiting. Another problem arises in the case when the participants are motivated to buy products and materials with a view to promoting and ranking higher.

When the participants have to pay for enlisting, promotion, training and services in order to be able to rank higher, they invest in a pyramid. Meanwhile, if, in order to determine them to enter the business, they are promised important gains, law is again broken.

## **5. CONCLUSIONS**

This paper attempts at approaching a topical subject, extremely mediated worldwide and ample, which, during the last period, seems to influence and attract a large number of individuals. This phenomenon is called Multi-Level Marketing (MLM).

The basic idea of the paper pinpoints this type of marketing, the operating means of Multilevel Marketing systems, be they legal or illegal, legit companies or pyramidal systems, pro and contra opinions.

We have implemented the method of document analysis and information structuring and the paper includes the study of the following topics: defining the terms of “Multilevel Marketing”, “Network Marketing” and “Pyramidal Systems” as well as their functioning, the manner according to which fraudulent MLM companies may be detected, opinions of professors, physicians or investors regarding the Multilevel Marketing systems.

After having analyzed specialized works, we set forth the structure and operational mode of the Multilevel Marketing system as well as the advantages of this industry.

Multilevel Marketing regards the activity of distributing, selling or offering products or services through several levels of independent agents. Meanwhile, in the case of Multilevel Marketing, the agents also receive bonuses and commissions from the sales of those they recruited as well as from the sales of the individuals recruited by these new agents.

A company that employs this type of marketing is a multilevel company. It may be a firm, an individual, a corporation or any other entity. Avon, Amway, Herbalife, NuSkin, all these are multilevel companies. They may be legal or illegal. Everything depends on their operating mode.

As far as pyramidal schemes are concerned, the Romanian Direct Selling Association defines them as “illegal gain procedures, virtually designed as a pyramid or a pyramidal structure, where the levels of the pyramid include individuals who pay a certain amount when entering the scheme”. The general gain rule is as follows: the persons who reach the top of the pyramid may earn money only in the case when the scheme is joined by a lot of people at the base of the pyramid. Each person has to pay an entrance fee; after that, he/she is compelled to recruit other people who should also pay the entrance fee. Their gain includes the amount of the entrance fees of the persons at the basis of the pyramid. It means that those who enter the base of the pyramid pay for the few persons at the top of the pyramid. Each new participant pays for his/her chance of getting to the top of the pyramid and of making a profit from the payments of those who will later enter the game.”

The people who promote these schemes are “masters of mass psychology”. They are called that because, on the occasion of each recruiting session, they spread a “real frenzy, an atmosphere of enthusiasm where the pressure exerted by the group and the promises of fabulous gains manipulate the greed or fear of the people for not losing a lucrative business”. Ordinarily, all meetings include a questions and answers session, but, in this case, questions are discouraged; as a result, it is difficult for those present at the meeting to realize that this is not the perfect business it seems to be.

In order to look like a network marketing company, a pyramidal scheme resorts to a line of products and asserts that its goal is to market these products. Nonetheless, the real effort made for selling the products is insignificant or entirely inexistent. In exchange, money is collected according to the typical style of pyramidal schemes: through recruitment. What characterizes these pyramids is the fact that the new distributors are compelled to buy large and expensive amounts of products when they enter the scheme.

A legit system of Multilevel Marketing relies on the personal sales within Transactional and Relational Marketing. Transactional Marketing comes from the classic theory of management and emphasizes the idea of the 4P of marketing mix: price, product, promotion and placement. Transactional marketing is short-term guided, more suitable for generic products and assumes that all customers are sensitive to price.

Relational Marketing is defined as the building, development and maintaining of a stable relation with the consumers in order to get high gains. It may be implemented in various ways through an active involvement of all marketing activities. Direct selling and the particular case of Multilevel Marketing employ the best techniques to settle profitable and long-term relations. Relational marketing relies on confidence, personal connections, communication, empathy and reciprocity. As opposed to transactional marketing, relational marketing targets the creation of a valuable proposal able to improve consumer’s experience process. Multilevel marketing combines transactional marketing and relational marketing together with the entrepreneurial skills of the company’s members for better sales and recruitment.

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