



DIRECT SELLING ASSOCIATION

## The Facts about Internal Consumption

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The direct selling industry has been in the news recently as a result of inquiries by a prominent hedge fund manager. The inquiries arose from a question about “internal consumption”—the products and services purchased by direct sellers for their personal use. Internal consumption is often misunderstood and mischaracterized, when in fact it is a perfectly legitimate part of direct selling. As the association representing more than 200 leading firms that manufacture and distribute goods and services sold directly to consumers, we at the Direct Selling Association (DSA) would like to set the record straight.

### **Internal Consumption Is a Legitimate Business Practice**

Nearly 16 million Americans engaged in direct selling in 2011, some as full-time entrepreneurs seeking to build a business and some as part-time representatives hoping to earn a little extra money. Others sign up as representatives simply to purchase products or services for their own use at a discount and never sell to anyone else. Regardless of their income expectations, almost all direct sellers use the products themselves. This is what is known as internal consumption.

As the Federal Trade Commission (FTC) stated in a January 2004 Staff Advisory Opinion, internal consumption is not considered to indicate impropriety. Instead, “the critical question for the FTC is whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that are not simply incidental to the purchase of the right to participate in a money-making venture.”

In short, what the FTC watches for—and what the DSA Code of Ethics is designed to protect against—are compensation systems that are funded primarily or exclusively by payments made for the right to recruit other participants. Compensation must primarily be based on the sale of products and services to the ultimate consumer—whether or not that consumer is also a seller of the products. We believe the law, and resultant anti-pyramid enforcement, to be quite clear and settled on this issue. Compensation received by salespeople for products they themselves buy and use, and those bought and used by other salespeople within their organization, is a legitimate, legal and ethical practice and not evidence of any impropriety.

### **The Myth of the “70 Percent Rule”**

We call the “70 Percent Rule” a myth because it isn’t an actual rule. Instead, it represents an industry-adopted practice. The “rule” was first cited in 1979 when the FTC definitively determined that Amway was not a pyramid scheme. Among the evidence cited was the fact that company policy required 70 percent of inventory purchased during the past month to have been sold in order to qualify for compensation.

Illegal pyramid schemes often disguise themselves by encouraging “inventory loading”—convincing people to buy large amounts of inventory which they cannot easily sell to others and is not returnable. The FTC found Amway’s “70 percent” requirement to be helpful in demonstrating that compensation was based on sales, not recruitment, and that no inventory loading was taking place.

Since that decision in 1979, many other companies have proactively adopted policies similar to the one Amway had in place. Additionally, there have been cases when law enforcement has taken action against an alleged pyramid scheme, ultimately requiring the company in question to adopt a version of this policy in order to continue to operate as legitimate, reformed operations.

The percentage of internal consumption varies by company, and regardless of the level it is not an indicator of a company’s overall financial performance or health. The same is true of the “70 Percent Rule”—some companies adopt it, some don’t. Importantly, DSA members also must abide by the Code of Ethics designed to protect both representatives and consumers.

Millions of Americans and people around the world benefit from the income they make through direct selling and enjoy the products they purchase. Direct sellers are the original word-of-mouth marketers—using personal recommendations to connect people and products. In a time when social media makes word-of-mouth a preferred method of gathering information and making purchasing decisions, direct selling couldn’t be more relevant.