

## Analyzing the Approach of Multi-Level Marketing and its Demand among Industries

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### Abstract

In Multi-Level Marketing, they promoted their brand and service through their dealer who sale their products, service to the customers. They educate and allow their new dealer to do the same service. This study highlights the several protocols and legal problems facing multi-level marketing, although it appears to be a development and we focus on those issues and help us understand why a Multi-Level Marketing latest version continues to occur. Even though it has many negative comments, soon it was implemented. The features of Multi Level Marketing were (a) multi-level marketing function (b) the regions in rules and regulations and (c) why now employed and implied counter measures May not detract. Furthermore, based on our long comprehension of MLMs and also their issues, we propose additional countermeasures.

**Keywords:** *Company image, distributors rewards system, distributors training system, product innovation, leadership, multi-level marketing, sustainable competitive advantage.*

### Introduction

Multi-Level Marketing (MLM) has a broad definition and sometimes referred as direct selling, network marketing or referral marketing. This business model existed since year 1945 with the dual way of retailing through distributor's network and sponsoring or recruiting new distributors to do the same (Keep & Nat, 2014) and it has been made known In recent decades, many foreign-owned MLM companies have chosen Malaysia to setup as first country in Southeast Asia, therefore creating huge competition among homegrown MLM companies. The

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MLM business is regulated by the Direct Selling Association of Malaysia (DSAM) which adheres to the requirement of the Direct Sales and Anti-Pyramid Act 1993. In 2017, MYR13,650 million has been contributed by Direct Sales Industry to our country economy (data.gov.my). Malaysia also has been in the Top 10 list of Direct Sales Global Market which represents 3% of global sales (WFDSA, 2018). Due to the long MLM history, Malaysia has been chosen as a hub in SEA by foreign owned / international MLM companies for training and developing their executive level employees. Among the top 20 MLM companies by global revenue in 2017, eleven companies are devoted to selling ‘wellness’ products which is shown in figure.1 correspondingly [4]. Some companies such as Herbalife and Usana are specialized in dietary supplements and weight control, other enterprises sell dietary supplements as well as a wide range of products such as disinfectant cleaners, skincare, make-up, air purifiers and cookware. On their official websites, these companies claim a wide range of benefits to nutritional status and health. In fact, companies are responding to people's deluded demands for health and fitness maximization, anti-aging solutions, immunity improvement, boost of metabolism, weight loss, vitality or organs ‘detoxification’. Moreover, some distributors make illegal claims, for example, that nutritional supplements can cure all sorts of diseases or illnesses. In 2016, the watchdog organization Truth in Advertising investigated the 62 companies selling nutrition supplements that were members of the Direct Selling Organization. They found that 60 of them (97%) had illegally claimed or were claiming either directly or through their distributor’s e that their products could treat, cure, prevent, alleviate the symptoms of, or reduce the risk of developing diseases or disorders [5]. They found more than 2000 problematic product claims made by those companies. Consequently, the lack of truthfulness within the MLM strategies has become particularly problematic. We must also ask whether this marketing strategy for nutrition supplements is legal and ethical in and of itself. Can physicians and dieticians legitimately become distributors?



Figure 1. Global sales by product category in 2016

## **Is Multi-Level Marketing a Legal Practice?**

MLM business originated in the USA in 1934 with the California Vitamin Company today called Nutrilite (Amway product) and exported worldwide. Selling dietary supplements through MLM strategies can be considered legal when the company and its distributors follow the legal framework and regulations made by the different legislations around the world. In The United States (USA) the regulation of MLM business is made by The Federal Trade Commission (FTC) and in Europe by the Directive 2005/29/e of the European Council which regulates unfair commercial practices [6]. However, some legitimate MLM organizations share many of the same characteristics of illegal marketing scams (called pyramid scheme companies). Looking at this market from a legal point of view, the issue is not black and white and entails more complicated consideration. Sometimes it is a challenge for regulators and for customers to identify companies that operate in the “grey area” [1, 7]. The pyramid scheme and MLM strategies depend on recruiting people to become distributors of a product or service, but the entire purpose of the former is to get gullible people's money and then use these people to recruit other so-called ‘distributors’. Thus, the primary distinction between the two is that the latter compensates their salespeople for selling products or services to ultimate consumers and not simply for recruiting people. This difference is blurred and difficult to prove.

Nevertheless, the grey area exists primarily because of the inventory of nutrition products they sell. In theory, this inventory will eventually be sold to customers. However, it must be purchased before it can be sold [1]. This can create a problem; a firm may only require a small fee for a representative to get started but the person must really buy a huge quantity of inventory. The fact that more money is being made from the inventory sold to new recruits than from legitimate sales to customers is highly questionable. This practice is called “inventory-loading” or “front-loading.” The company will increase its sales and overall profits, but the distributor can incur heavy economic loss. Some of the MLM nutrition companies like Herbalife have a clear unabashed ‘frontloading’ practice. Another misleading practice is the introduction of a ‘starter kit’ as in the Usana practice. In order to get into the company's commission program, a Usana associate must be responsible for an initial fee, of for example, \$20 to \$50 for the starter kit, buy roughly \$150 in products and then order about 120 dollars' worth of goods each month, either for selling or personal use. In other words, distributors can make money by selling products to people who want them, but they can make much bigger profits by recruiting other salespeople and getting a share of their revenue [8].

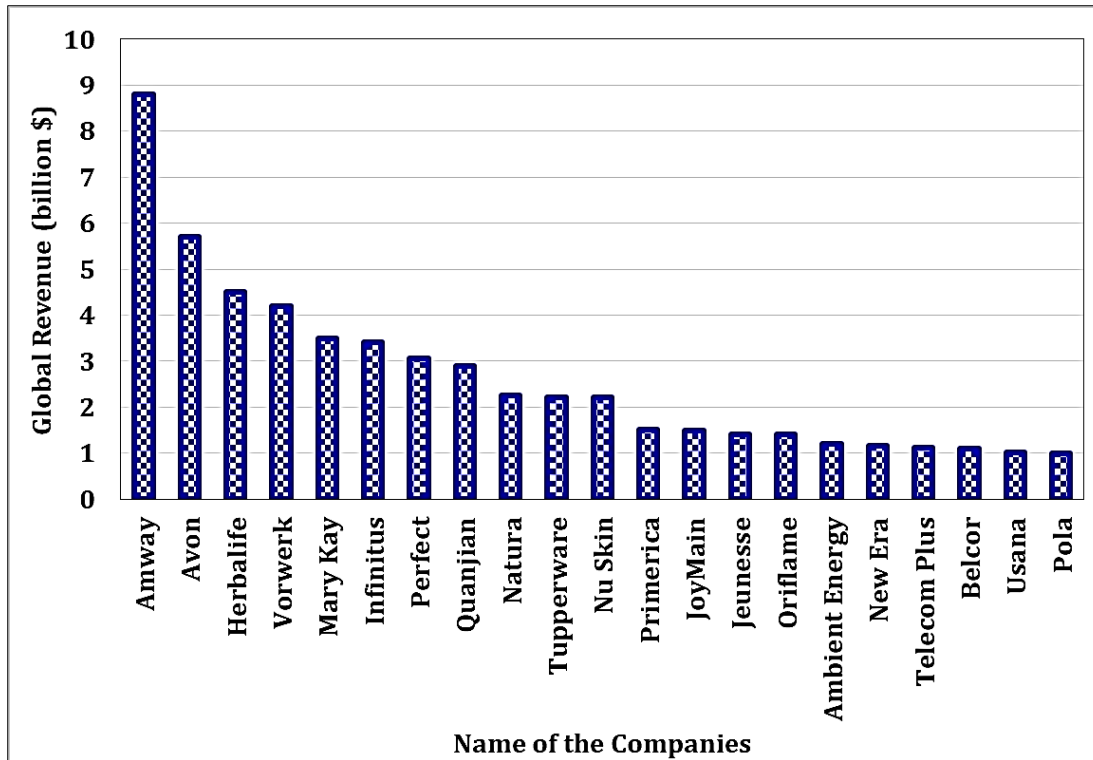


Figure 2. The top 20 multi-level marketing companies by global revenue in 2017

### Are Herbalife and Usana Pyramid Schemes?

According to the definition of a pyramid scheme and testimonies from thousands of distributors, we consider they are at least “pyramid-shaped”. Legal processes in USA and Europe have been controversial. In 2011, after a long process a Belgian court found Herbalife to be pyramid scheme after examining its marketing plan [9]. The decision was appealed by Herbalife. On the other hand, in the USA FTC determined in 2016 that Herbalife was not a pyramid but a “problematic” scheme mainly because the distributors obtain their monetary benefits primarily from recruiting rather than by selling goods to consumers. Several measures were introduced to ensure that MLM businesses do not operate as illegal pyramid schemes. Herbalife was asked to change their model and to pay \$200 million in an agreement with the FTC to partially refund roughly 350,000 Herbalife distributors. The FTC made a sensible decision, because the whole USA MLM industry was at stake. The economic impact would have been huge. Thus, considering that MLM strategy is legally permitted in Europe and the US we must ask if all the products particularly the nutrition products can legally be sold. The answer is yes: companies can sell dietary products if they are in compliance with all applicable laws and regulations concerning it. In Europe, the European Food Safety Authority (EFSA) established the Food Supplements Directive (FSD) Directive 2002/46/EC, and the regulation on nutrition and health claims Regulation 1924/2006 [10]. In the USA, dietary supplements are regulated under the FDA as foods (the FDA Food Safety and Modernization Act, signed into law on January 4, 2011 regulates the safety and labelling of these products) and the Federal Trade Commission (FTC); enforced by the State Attorneys General Offices (AGO) and Department of Justice (DOJ), and monitored (not regulated) by the Centers for Disease Control and Prevention (CDC). False claims include misbranding and illegal advertising, which violate

FDA and FTC laws respectively [11, 12]. Dietary supplements are officially defined as foods, not drugs, and require that every dietary supplement be labelled as such. This means that dietary supplements do not need approval from the FDA before they are marketed. Except in the case of a new dietary ingredient, where pre-market review for safety data and other information is required by law, a firm does not have to provide the FDA with the evidence it relies on to substantiate safety or effectiveness before or after it markets its products.

According to the FDA Code of Federal Regulation when the supplement “describes the role of a nutrient or dietary ingredient intended to affect the structure or function of the body, the manufacturer is responsible for ensuring the accuracy and truthfulness of these claims”, thus, the company is required to print “This statement has not been evaluated by the Food and Drug Administration. This product is not intended to diagnose, treat, cure or prevent any disease” [13]. In fact, only a drug can legally make such a claim. The way around this is to have someone other than the company or its distributors make all the health claims.

### **The Ethical Argument against Multi-Level Marketing in Nutritional Products**

Assuming that the MLM companies are not fraudulent, is it possible to consider this an ethical strategy? Ethics is a branch of philosophy that aims at conducting an intellectual analysis of the moral human dimension in all of its complexity. Ethics is concerned with principles that allow us to make decisions about what is right and wrong. In other words, ethics is the study of what it is morally right and what it is not. It refers to a judgment of behaviour, good or bad. The ethical principles of autonomy, beneficence, no maleficence and justice as proposed by Beauchamp and Childress [14], are internationally recognized. They are known as principlism and are conceived as part of a common moral ground that permits a practical approach for ethical decision-making. Under this approach, we will analyse the ethical issues concerning the MLM of nutrition products. The MLM strategy to sell nutritional products is surprisingly well accepted in our Western culture and it has been implemented as a recognized practice even among doctors, dietitians and other healthcare professionals. But is it ethical? First, the principle of beneficence imposes an obligation to act for the benefit of the patient and physicians and healthcare professionals have to follow professional obligations and standards. Do dietary supplements and other nutrition products provide a benefit to customers? This means questioning the efficacy of the products. The efficacy of vitamins and minerals supplementation in the treatment of different diseases or conditions caused by nutrient deficiency is well known (i.e., vitamin A and blindness, vitamin C and Scurvy, vitamin D and rickets, etc.), and certainly need to be administered within the framework of a medical care situation and under expert recommendation. However, the scientific evidence about the efficacy of dietary supplementation with vitamins and other nutrients to treat or control diseases other than those caused by nutrient deficiency is scarce and frequently lacks any solid clinical trials.

The Office of Dietary Supplement recently published the review of dietary supplement efficacy and safety. The lack of clinical trials proving the safety and efficacy of dietary supplements can be explained because the regulations do not demand it as opposed to pharmaceuticals that are vetted for a certain degree of proven efficacy and safety, and where usually new medicines

often lasts several years and costs millions. Moreover, those clinical trials are not a research priority basically because the products are defined as foods and in most the cases they are not financially feasible [12]. Nevertheless, the MLM dietary supplements strategy is founded on the assertion that all people need a dietary supplement every day and for a number of reasons. For example, Nutrilite states that supplementation is intended to fill dietary nutrient gaps “between what we need and what we eat”, moreover, Usana affirms that “you can trust that the supplements are an excellent choice for a comprehensive micronutrient supplement you can choose to nourish, protect, and renew your health every day and optimize your health span with normal aging.” [15]. accordingly, everybody will find a product that will fit his or her need. But those affirmations lack any scientific grounding. Thus, from an ethical point of view, to supplement diet is a good practice when it is framed by an expert knowledge to ensure benefit. Worryingly, any person can become a nutritional supplement MLM distributor and whoever signs an agreement with a company such as Herbalife or Usana becomes a “health advisor”. There aren't any requirements and the person need not be knowledgeable in the health or nutrition field.

Millions of people around the world have signed up, attracted by the misleading and altruistic idea of helping or changing people's lives and at the same time making a lot of money. For example, Herbalife asks it would be distributors: “Are you ready to help change people's lives with the best nutrition and weight-management products in the world?” [16]. In some countries like in Ghana, becoming MLM distributors means gaining higher social status and profit [17]. It is obvious that being a MLM distributor does not make anyone an expert. What is questionable is the misinformation, lack of education and proper training of the distributors. Thus, it is necessary to ask whether the MLM nutrition products, distributed by either a healthcare profession or not, will potentially be harming. The principle of normal efficiency imposes an obligation not to inflict harm on others. If the risks and burdens of a therapy for a specific patient outweigh the potential benefits, then the physician has the obligation not to provide the therapy. Harm is concerned with treatments that have an adverse effect. This is more than being wrong, or unjustified; harm can be psychological, moral or physical.

The most significant safety concern posed by supplementation is the sale of adulterated products. According to AC Brown, the “adverse side-effects, if any, are often due to a minority of unscrupulous manufacturers who engage in illegal adulteration with drugs or New Dietary Ingredients (NDIs) which the government infrequently exercises its the power to control”. The number one adulterant in dietary supplement is drugs, followed by an unquantified number of NDIs that were not submitted to the FDA prior to marketing. Both are illegal [12]. Adverse effects of nutrition supplements are responsible for an average of about 23,000 emergency department visits per year, according to a study published in 2015 in *The New England Journal of Medicine* [18]. The nutrition supplements concerned were herbal, dietary products, vitamin or amino acid micronutrients. Weight loss products accounted for one quarter of all single-product emergency department visits and disproportionately affected women, while men were more likely to experience adverse effects from products advertised for sexual enhancement and body building. The use of a large number of dietary supplements and herbal products often distributed by MLM as “natural” is highly suspected to be toxic. However, “natural” is not

always synonymous with safe. The case reports in tabular form related to liver toxicity, kidney toxicity, cardio toxicity, and cancer published from 1966 to May 2016 in the medical literature have been recently published by AC Brown. [12, 21, 23, 25].

This was published together with an online “Dietary Supplements Toxic Table” that provides clinicians, consumers, and manufacturers with a list of herbs and dietary supplements that could potentially contribute to organ injuries (liver, kidneys and heart) and cancer. The aim of the “Toxic Table” is to be continually updated to assist researchers and clinicians in preventing serious adverse events from dietary supplements. Thus, from an ethical point of view, the respect of the normal efficiency principle is at stake largely when a non-expert distributor, not knowing these risks, recommends a dietary supplement to customers.

**Why dietary supplements are extensively consumed worldwide despite potential risks and frequent unproven efficacy?**

Approximately half of US adults consume dietary supplements of which the primary reasons are to promote overall health and wellness, and fill dietary nutrient gaps [19, 20]. The supplements most frequently consumed in the USA are shown in Table.1 [21]. The reasons most often cited for supplement use were for overall health and wellness (58%) and to fill nutrient gaps in the diet (42%) [22].

In Europe, the dietary supplements consumption varies from one country to another but, it is recognized as a lucrative market, with increases in sales values forecast across Europe. In France for example, 15, 8% of the adult population consumed supplements in 2010 [4]. The reasons most often cited for supplement use in France were to fight fatigue (33%), particular conditions or health diseases (21%) and overall health and wellness (17%).

Table 1. Supplements most frequently consumed in USA and Europe in 2011 [27, 28].

Vitamin or mineral supplements	67%	63%
Specialty supplements (includes chondroitin, CoQ10, enzymes, homeopathic preparations, hormones, melatonin, omega-3 fatty acids, probiotics, SAME, etc.)/Natural Products.	35%	14%
Botanicals herbs	23%	21%
Sports supplements (includes amino acids, creatine, protein formulas, fat-burners, ribose, androstenedione)./Others	17%	2%

The close historical development between herbs, botanicals and drugs as well as the long history of use of botanicals in traditional medicine contributes to the presumptive belief in some therapeutic efficacy of the nutritional products [23]. Moreover, people are not being informed about the lack of proof of efficacy and distributors are promoting the general belief about the safety of these products. In addition, meetings of MLM companies are used to motivate distributors to make “personal statements about how products cured their health problems” [30]. The risk of distributors is to, willingly or unwillingly, misrepresent products. Personal and confessional stories about being cured and treated by a nutritional supplement are

acclaimed [24, 25]. The idea that is conveyed is that the personal use of dietary supplements and nutrition products turns consumers into experts, thus suggesting that their own consumption-based experience can replace independent, professional training [30].

Consequently, even if customers are making their own decision it can't be considered to be completely autonomous because this decision is taken without reliable and complete information. For a decision to be considered to be autonomous it must fulfil certain procedural criteria mainly truthfulness and complete information [26]. This could be ensured competently by physicians and nutritionists. We ask whether those professionals are legitimate to distribute MLM nutrition products. Conditions that are unsuitable for self-prescription as well.

The respect of the principles of beneficence, no maleficence and autonomy are at stake. Under no circumstance is it an ethical practice for physicians or other healthcare professionals neither for non-health professionals' distributors. The general public should avoid nutrition and health-related multi-level products altogether while government enforcement action against multi-level companies should be more vigorous and aggressive worldwide. Healthcare professional organizations should define policies and ethical recommendations on how, who and when should prescribe dietary supplements to avoid this practice.

## **Understanding how MLMs Operate**

### **Prevailing' Model**

The main purpose of this paper is to better understand why ethical and legal problems of MLMs persist (for some MLMs) despite current countermeasures. In our view, an important reason is that the prevailing conceptualization of how MLMs operate is insufficient for a proper understanding of the problems. Moreover, countermeasures that are based on this insufficient understanding may miss the mark. To make our point, we first need to explain both the prevailing and the extended models of MLMs.

### **The 'Prevailing Model' of MLMs**

Although no off-the-shelf, agreed-upon model of how MLMs operate exists in literature or practice, most commentators (regulators, academics, representatives of watchdog organizations) seem to have several 'MLM' constituents and relations between them in mind when describing MLMs (Brodie et al. 2002, 2004; Herbig and Yelkurm 1997; Peterson and Wotruba 1996). The three recurrent constituents are: MLM headquarters, independent distributors, and 'non-members.' Between these three constituents, usually three relations are implied. Below, we will briefly discuss these constituents and their relations. The 'prevailing model' consisting of these constituents and relations is what we call the 'main organization' in figure.3 Headquarters, as the first constituent of MLMs, is responsible for all key business decisions (products, markets, etc.) and for defining and establishing corporate policies, such as the conditions for becoming a distributor (e.g., no requirements except legal age of majority), the legal status of distributors as self-employed, and the commission system for selling and recruiting.



The second constituent refers to the self-employed distributors, who work from home, market company products, and/or recruit, teach, and motivate others to do the same. Although not part of the organization (yet), (prospective) clients and prospective distributors are normally included in explanations of how MLMs operate, thereby forming the third constituent in our model. They are approached, usually face-to-face, by distributors for buying products and/or joining the company.

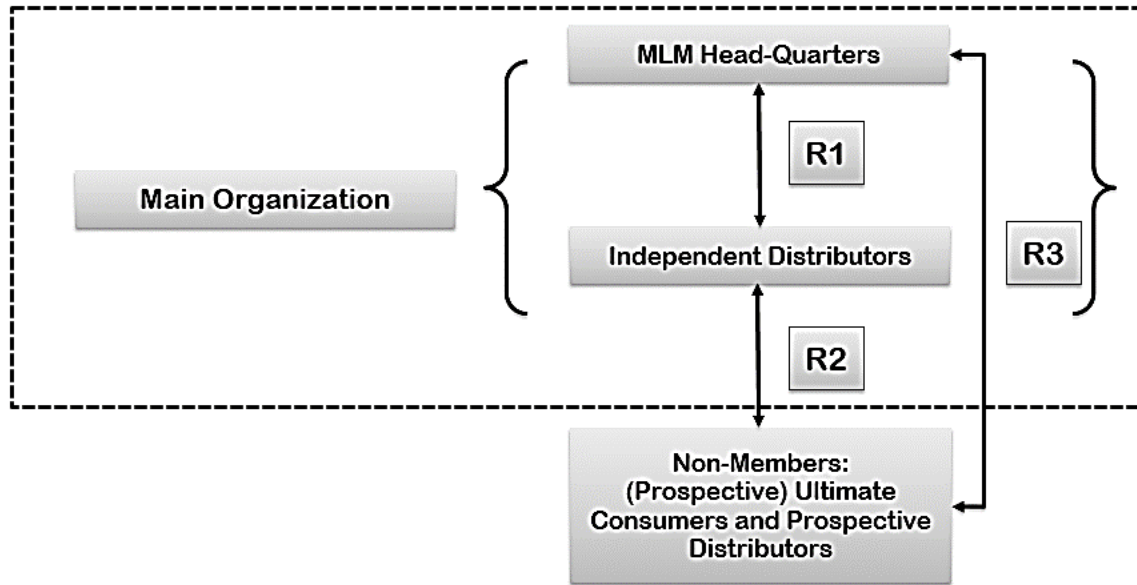


Figure 3. MLM Organization Model

Between these three constituents, three relations are normally described. The first relation is the one between the MLM headquarters and the individual independent distributors (R1 in figure.3). It refers to the formal agreement a distributor has with headquarters. It also refers to rules and regulations set by headquarters, such as the distributor agreement and the handbook regulating the rights (such as commissions) and duties (such as compliance to Code of Ethics) of a distributor. This includes under which conditions distributors are entitled to a specific form of compensation (e.g., commission, bonuses, or discounts on products) and the ways distributors are entitled to represent the company, sell products, and recruit others. In addition, handbooks provide distributors with specific information, such as product information, how to declare taxes, and how to work as a distributor. Codes of Conducts provide guidelines for the way distributors should approach prospective clients and recruits. These codes include, for example, rules against income and product misrepresentations.

The second relation (R2 in figure.3) describes the interaction between independent distributors and prospective distributors and clients. This relation refers to the way distributors approach and deal with clients and how they recruit other distributors. These practices are, in part, governed by the rules and regulations featuring in relation R1. That is, headquarters expects that distributors behave appropriately toward non-members (relation R2) (as indicated in the rules and handbooks for and the formal agreements with independent distributors—which are part of relation R1).

The third relation (R3 in figure.1) is the one between MLM headquarters and non-members. Headquarters regulates, for instance, the rights of prospective and actual clients as well as the rights of prospective and newly recruited distributors in relation with headquarters. Examples include the abovementioned buyback policies for products or cancelation policies, such as a 'cooling off period' for customers to return their purchases (WFDSA 2008, p. 8) and for new distributors the right 'to withdraw from his agreement without penalty and without giving any reason' (Seldia 2011, p. 25). The prevailing model of MLMs allows us to understand how existing countermeasures are directed at the three relations of the main organization: first, rules such as the restriction of levels for which up line members can receive override commissions regulate the relation between headquarters and distributors (relation R1 in figure.1); second, Codes of Ethics, including guidelines for how to approach consumers, have been set up to ensure that distributors treat non-members in appropriate ways (relation R2); and third, rules such as buyback policies define headquarters' obligations toward end consumers (relation R3).

Based on the prevailing MLM model, it is difficult to explain why the broad range of existing countermeasures does not suffice to ensure ethical behavior. Here, Mintzberg's (1983) conceptualization of how different kinds of organizations need different kinds of coordination mechanisms may offer a way out. Whereas bureaucratic organizations can strongly rely on formalization to coordinate work, coordination in organizations 'where jobs are sensitive or remote ... must rely on training, and especially on indoctrination' (Mintzberg 1983, p. 41). We argue that MLMs are organizations that primarily rely on coordination by training and indoctrination. This claim is based on Biggart (1989), who argues that MLMs are not ideal typical bureaucracies (as distributors are legally independent, central bureaucratic elements such as formal employment contracts, fixed working hours, a prescribed tenure system, and the possibility for managers to exercise authority based on rational-legal authority are missing).

Moreover, the self-employed distributors work from 'remote' locations, i.e., private homes. Finally, as the literature referred to in Sect. 2 illustrates, jobs at MLMs can be categorized as ethically sensitive. Given these coordination mechanisms of MLMs, one way of approaching the question why legal and ethical problems persist is by gaining a better understanding of training and 'indoctrination,' i.e., socialization (Schein 1990) at MLMs. Former distributors (Andrews 2001; Scheibeler 2004; Smith 2013; Sonnabend 1998) and academic research (see "The legal and ethical problems of MLMs and existing measures to deal with them" Section) have described that socialization plays a relevant and potentially problematic role at MLMs. One might even argue that the strong form of socialization observed in some organizations (Bromley 1998; Grog 2008; Pratt 2000a) can be understood as a form of clan control (Ouchi 1980), as MLMs employ 'a variety of social mechanisms ... to produce a strong sense of community' (p. 136). Finally, based on the theory on the normalization of corruption (Ashforth and Anand 2003; Ashforth et al. 2008), it becomes clear that coordination by means of training and socialization can also lead to highly problematic organizational behavior. For instance, the idea of the 'social cocoon' (Greil and Rudy 1984, in Ashforth and Anand 2008; see also Jackall 1988) explains how new members are socialized into showing corruptive behavior, which is comparable to what happens at some highly problematic MLMs.1, 4, 10. Although several authors analyze how socialization takes place at MLMs (see "The legal and ethical problems

of MLMs and existing measures to deal with them’’ Section, ‘Total institutions’; i.e., Biggart 1989; Bone 2006; Cahn 2006; Friedner 2014, 2015; Grog 2008; Krige 2012; Lan 2002; Pratt 2000a, b), we still know little about how socialization that leads to ethically problematic behavior and who is responsible for it. In the next section, we will explain that the responsibility for socialization lies with what we call the distributor network (DN). This DN is a specific MLM constituent. Extending the prevailing MLM model with this constituent, we argue, will help us to better understand (the persistence) of legal and ethical problems.

### Conclusions

While considering that MLM of dietary supplements and other nutrition products are a legal business strategy, we affirm that it is an unethical practice. MLM products that have nutritional value or promoted as remedies may be unnecessary and intended for conditions that are unsuitable for self-prescription as well. The respect of the principles of beneficence, nonmaleficence and autonomy are at stake. Under no circumstance is it an ethical practice for physicians or other healthcare professionals neither for non-health professional’s distributors. The general public should avoid nutrition and health-related multi-level products altogether while government enforcement action against multi-level companies should be more vigorous and aggressive worldwide. Healthcare professional organizations should define policies and ethical recommendations on how, who and when should prescribe dietary supplements to avoid this practice.

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