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Briefing Paper

Direct Sales in China

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Introduction:
Although the Chinese government has complied with many of its World Trade Organization obligations, many issues remain unresolved, including China's direct selling regulations. In 2005, China's State council announced the Direct Selling Administration Regulations and the Ministry of Commerce began approving license applications in 2006. Today there are twenty-four licensed direct selling companies in China. Of the twenty-four, approximately three-quarters are engaging in direct selling operations, while the remaining are inactive. Twelve additional companies are awaiting approval. Countless other companies engage in some variation of direct selling without a license. This article will analyze the issues presented by China's direct sales regulations and offer recommendations to improve direct selling in China.

Licensing Process & Service Center Establishment:
Current licensing processes often unnecessarily burden companies looking to comply with regulations, while allowing illegitimate companies to thrive. The licensing process indicates that the approval process takes only ninety days. However, many companies have continued to wait for over eighteen months without a response.

Even after obtaining the proper license, direct sellers face an additional obstacle of satisfying the service center requirements set forth by the regulations. According to the regulations, a direct selling company must have a branch office in every province in which it operates, and a service center in each urban district in which it sells products. In order to cover all of China's districts a company would be required to establish 2,861 service centers. Lehman, Lee & Xu suggests that the Chinese government simplify the process and allow individual companies to base the number and location of service centers on their market-driven needs.

Furthermore, the current approval process requires a company to receive district, city and provincial-level approvals for its service center establishment plan prior to submitting the plan to the Ministry of Commerce. If its plan is approved, a company must reacquire approval from the district, city and provincial-levels. Lehman, Lee & Xu suggests to delegate the service center establishment plan approval to the provincial level only. Lehman also recommends eliminating the requirement for service center approval prior to beginning business. These recommendations would reduce the time, cost and complexity of a direct sale application.

Compensation Restrictions:
The current regulations restrict direct sellers' compensation to personal sales, and up to 30 percent of personal sales volume. Lehman, Lee & Xu believes this restriction removes all incentive for career development as a direct seller and thereby is disadvantageous to direct selling companies who rely on experienced sales personnel to sell their products.

Compensation restrictions are also contrary to world-wide practice. Globally, governments do not restrict compensation for direct sellers. Removing compensation restrictions would provide greater economic reward and grant companies greater means to motivate their sales forces.

Limited Permissible Product Categories:
The regulations have limited direct sales to products from five categories: cosmetics, dietary supplements, cleaning products, health exercise equipment and small kitchenware. Global practices only limit restricted goods (e.g., firearms and prescription drugs), perishable goods (e.g., food and fresh produce), goods whose value is indeterminate by the average consumer (e.g., precious stones and investment packages) and bulk commodities (e.g., metals) from direct selling. Lehman, Lee & Xu believes that reforming direct selling regulations in China to conform with the worldwide standard would benefit the direct selling industry in China and give consumers access to a wider array of products.

National Treatment Issues:
The regulations have also set forth different standards for foreign-invested companies and domestic companies. Foreign-invested companies are required to have at least three years of direct selling experience in other markets before applying for a Chinese license. There is no such requirement for domestic firms. Lehman, Lee & Xu believes this to be contrary to the "national treatment" obligation under the World Trade Organization accession agreement and urges authorities to eliminate the requirement for foreign-invested companies. Removal of this requirement would promote non discriminatory, equal treatment of foreign and domestic companies engaged in direct selling.