

EQUITY

RESEARCH:

UNITED STATES

Internet-Direct Selling

July 21, 2000

Please note: This is an excerpt from the complete 76-page study conducted by Salomon Smith Barney

Clicking on the Direct Selling Industry

The Next Phase in the Clicks-and-Mortar E-volution

- ▶ Absent major equity funding, successful online sellers will need to achieve profitability quickly by leveraging off existing customers, brand identities and infrastructures. We, therefore, see two virtually untapped distribution channels — direct selling and small businesses — benefiting from this new paradigm.
- ▶ We envision innovative pure-play Internet sellers creating relationships with large numbers of small businesses. This new "hybrid" model would allow small businesses to efficiently gain online sales.
- ▶ We believe there will be millions of online stores owned and operated by individuals (direct sales reps), each leveraging off of hundreds of existing relationships. Direct sales reps generate revenues through sales of products they personally sell, as well as from sales of representatives that they recruit and train. We forecast sales of the direct-selling distribution channel on the Internet growing to \$33 billion by 2004.

United States

In this report, we analyze the online direct-selling industry, which we believe will be the next phase within the clicks-and-mortar e-revolution.

Consolidation within the e-tailing space should benefit the “hybrid” clicks-and-mortar retailers.

The Internet retailers have incurred sharp declines in market capitalization, as investors focus on customer-acquisition costs. With less funding, pure-play e-tailers will no longer have enormous marketing budgets to build a brand and generate traffic. Although pure-play e-tailers often possess the first-mover advantage, more innovative content and stronger online market expertise, e-tailing winners will likely be clicks-and-mortar “hybrid” retailers. Absent major equity funding, successful online sellers will need to leverage off of existing customers, brand identity and infrastructure (procurement and fulfillment capabilities of traditional bricks and mortar retailers). As a result, we see two virtually untapped distribution channels — direct selling and small businesses-benefiting from the new paradigm.

The “hybrid” Internet retailing model that consists of relationships with small businesses offers tremendous potential.

Small bricks-and-mortar businesses have been virtually shut-out of the e-commerce revolution due to high capital cost requirements, lack of expertise and significant management focus needed to launch a high-quality e-commerce capable website. However, smaller businesses possess numerous success factors, which include access to existing customers, strong brand image and personalized customer service. We therefore believe this overlooked distribution channel could become a powerful driver of online sales. We anticipate innovative online sellers forming strategic relationships with these smaller businesses beyond the traditional affiliate program model. We envision e-tailers developing a “turnkey solution” for these smaller businesses, which effectively locks-in important relationships, while allowing these small businesses to effectively participate in the e-commerce phenomena.

We anticipate millions of individuals selling products on their own websites. We believe there will be millions of online stores owned and operated by individuals who are able to leverage off of hundreds of existing relationships. These online stores will sell either niche (e.g., personal care, nutritional products, technology oriented) or very broad (e.g., providing links to leading online sellers within numerous online shopping categories) product offerings. The individual would receive a 5%-15% commission from net sales generated by the website. We believe direct-selling sales on the Internet will grow to \$33 billion in 2004 due to the following key drivers: the allure of owning a dot com business, strong customer loyalty, existing relationships and high customer service.

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Company Description

Rexall Sundown is a leading developer, manufacturer, and marketer of vitamins, herbals, nutritional supplements, and consumers' health products. Royal Numico, a European consumer products company and owner of GNC, recently announced the anticipated acquisition of Rexall Sundown. Sundown's products are marketed under company-owned trademarks through three channels of distribution: sales to retailers; direct marketing through catalog and mail order; and direct sales through independent distributors. Rexall Showcase International is the company's network marketing subsidiary that distributes and markets a unique line of weight management products, homeopathic medicines, personal care products, and water filtration devices to independent dealers.

Site Evaluation

Rexall.com serves as an e-commerce, information, and recruiting site. It provides general product descriptions and recruits distributors. Currently, product purchasing is unavailable for the user. For the product descriptions, the site provides general information on nutritional supplements and personal care products. Distinct from other sites are the product descriptions, which offer an added touch by allowing users to see detailed information in a separate smaller browser window. When the user clicks on product info, it opens a new browser window. Touches such as these distinguish Rexall.com from other network marketing sites.

Distributor Resources

www.Rexall.com

We created our own personalized website with the URL labeled www.rexall.com/greg-badishkarian

badishkarian.com

Log On to My Rexall >

For almost a century, consumers have recognized the Rexall® name as a trusted partner in health. Now, we're reaching out online to impact individuals' health in new ways and enable people like you to benefit financially from the Internet.

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Overall, the distributors' e-commerce enabled websites are well-designed in terms of layout and ease of use. The categories are clearly defined and subcategorized. To go shopping, the user must become a free member and enter name, e-mail address, and password. Although this was relatively easy, the user needs to remember the information every time.

When shopping at the sales representative's site, the user is routed to Rexall.com's main site. There is no mention of product categories or individual items similar to a traditional online store. Instead, there was a search form. When attempting to get more information on certain products, an error message was displayed.

We believe that Rexall.com is the clear leader with respect to helping its distributors effectively market their dot com business. The site provides distributors with a "technology toolbox" containing dozens of free and paid marketing techniques (see Appendix I, Internet Marketing 101).