

## **Transformational vs. Transactional Leadership: A Path Analysis of the Direct Selling Industry in Thailand**

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### **Abstract**

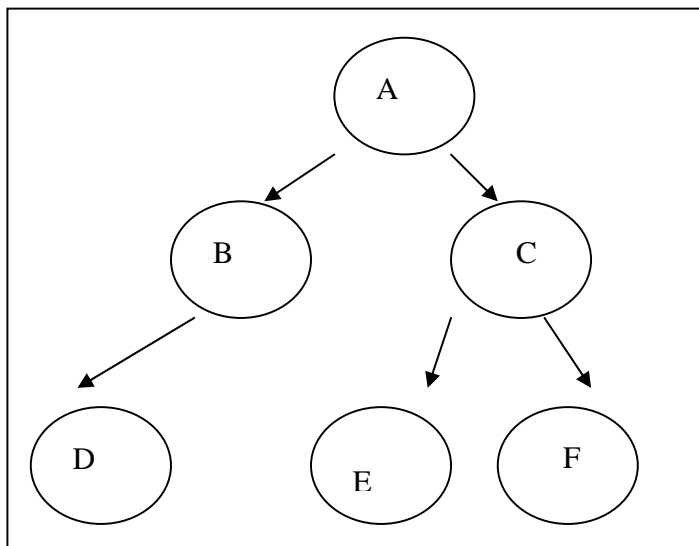
As the direct selling industry becomes more competitive, many direct selling firms are trying to find ways to succeed. The “distributor” or salesperson lies at the heart of the direct selling business. If there is no distributor, there is no revenue. In this industry, the distributors are independent from the company. Therefore, defining, measuring assessing distributor “style” becomes a critical issue. This paper investigates leadership style and its impact on performance in the direct selling industry. Specifically, this research focuses on the following questions: (1) What is the impact of “upline” (superior) leadership style on “downline” (follower) performance and work environment? and (2) Is there any relationship between leadership style and leader outcomes such as follower satisfaction, increased effort and effectiveness? In an empirical survey of 300 distributors in Thailand’s direct selling industry, it was found that, contrary to conventional wisdom and prior studies, ‘transformational leadership’ has no effect on follower performance while ‘transactional’ leadership has a negative effect on follower performance. However, both types of leadership style have a positive impact on follower satisfaction, increased effort and effectiveness. Implications for leadership training and strategy in the direct selling industry are discussed.

### **1. Introduction**

Direct selling is one of the oldest methods of commercial distribution. It can be defined as the process of selling a consumer product or service from one person to another, in an environment that is not a permanent retail location (Duffy, 2005). Direct selling organizations can be divided into 2 categories based on the type of marketing channel: single-level marketing channel firms (SLMs) and multi-level marketing channel firms (MLMs). The distinction between these two types of organization lies in the commission plan. MLMs have a more sophisticated commission plan compared to SLMs. MLM is generally known as “network marketing” which involves selling both the product and the business opportunity associated with selling the product.

MLMs consist of corporate-level producers that market branded goods or services through a network of independent, member-owned distributorships, which are usually operated from members’ homes (Sparks & Schenk, 2001). The distributor is required to purchase training and promotional materials from the direct selling organization and agrees to purchase a certain amount of inventory during a specific period. This arrangement is called an MLM distributorship. Depending on the company, the salespeople may be called distributors, representatives, consultants or by some other titles. Most of the products under MLM are sold primarily through in-home product demonstrations, parties and one-on-one selling.

In the case of SLM, the distributor will receive a commission from making a retail profit by selling the product/service. New members/ participants come from recruiting and training conducted by the manager of the direct selling company, who may or may not be self-employed themselves and may or may not themselves be involved in making personal sales. On the other hand, compensation programs in MLM may vary. Some plans allow recruits to “break away” from their sponsors eventually. Others require sponsors to “pass” one or two recruits “upline” to their immediate supervisor (Poe,1995). Even though there may be differences in the structure and terminology of compensation plans, the distributor will receive a reward from retail sales and from the sale (purchase) of those they recruit. MLM distributorships provide members with two sources of income. First, they earn income (called ‘commission’) by selling goods that they buy wholesale from one or more manufacturers or distributors. The exact amount of commission earned can vary widely depending on the structure of a particular organization as well as the depth of the sponsoring line (Kustin & Jones, 1995). In the simple illustration in **Figure 1**, three levels of a sponsoring line are shown. The second source of income is the commission gained from recruiting new members. To grow their distributor networks, corporate-level producers offer current members commission on sales by new members that current members recruit.



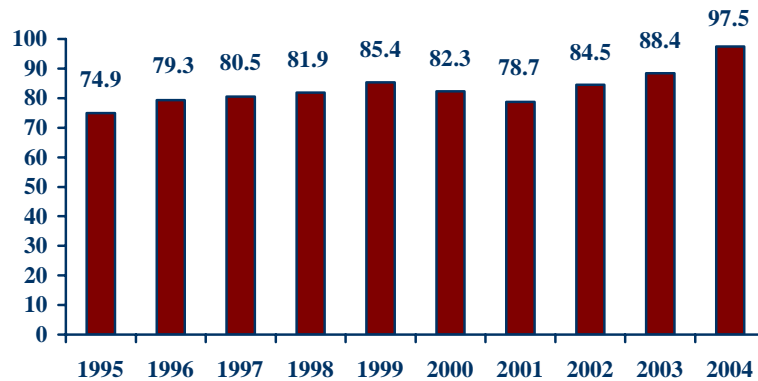
**Fig. 1 Sponsorship in Direct Selling**

Source: World Federation Direct Selling Association (WFDSA), October 2005

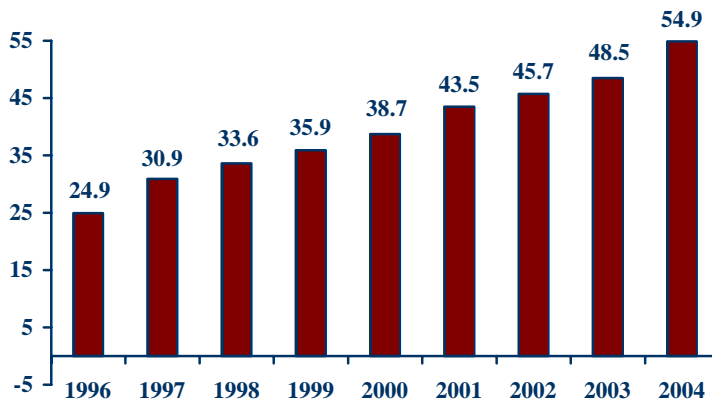
In the past few years, the direct selling business has grown very rapidly throughout the world. **Figure 2** presents data from the World Federation Direct Selling Association (WFDA) with respect to the trend in global retail direct sales from 1995 to 2004. Especially after 2001, there was continued growth in total sales. From 2003 to 2004, sales grew 10%. Not only did direct sales grow but global sales force as well. **Figure 3** shows the data for sales force growth from 1996 to 2004. As the figure indicates, global sales force grew from 48.5 million in 2003 to 54.9 million in 2004.

## 2. Direct Selling in Thailand

Like elsewhere in the world, direct selling has experienced significant growth in Thailand. According to the latest report (January 12, 2006) from WFDA total direct sales in Thailand were estimated at USD 880 million in 2004. Direct selling has been well known in this country for over a decade. Nonetheless, it is not well understood by the local people. Many people tend to confuse direct selling with direct



**Fig. 2 Global Direct Sales 1995-2004 (in US Dollars)**  
 Source: World Federation Direct Selling Association, October 2005



**Fig. 3 Global Direct Sales Force 1995-2004 (in millions)**  
 Source: World Federation Direct selling Association, October 2005

marketing. Direct marketing involves mailed catalogs, telemarketing, direct responses, advertising and infomercials. On the other hand, direct selling is the marketing activity involving contact between a consumer and a salesperson in a location other than a retail store, for example, in a home, workplace or neutral location.

In 2004, the size (total revenue) of Thailand's direct selling industry was estimated to be 32,000 million baht representing a 16.3% increase over the year 2002 (ABAC Poll, 2006). Moreover, 10 percent of Thai people used products from direct selling companies. There are approximately 6 million distributors participating in this industry. They can be divided into 2 categories: business members and consumer members. A recent survey indicated that there are 2 million business members and 4 million consumer members (ABAC Poll, 2006).

### **3. Nature of Direct Selling**

The direct selling industry is rather unique. The people who sell the products in this industry are independent salespeople or “distributors”. They are crucial to the success of the business. They are their own bosses and are independent from the corporate organization which supply them the products. Therefore, as noted by Crittenden and Crittenden (2004) noted: “With an independent sales force framework, it is imperative for direct selling firms to implement programs that aid in finding and keeping strong individual sellers.” These distributors do not receive any salary or benefits from the corporate office. However, even though they are independent entities, distributors usually work as a team. This team structure creates a “sponsorship” line. The sponsoring line shows the relationship between each distributor and the people they recruit below them (see **Figure 1**).

A salesperson can be a distributor as well as a recruiter at the same time. The people at the higher level (the recruiters) are referred to as the “upline” while those being recruited are called the “downline”. For example, in Figure 1, if A recruits B and C into his team, we call A the upline and B and C the downline. If C recruits E and F into his team. E and F will be downline of both C and A. C will be the upline of E and F and the downline of A. Nowadays, recruits are generally called “partners” instead of downline.

Virtually every distributor has a downline. The upline-downline relationship is akin to that of a leader-follower. However, in the direct selling industry, the relationship between the upline and the downline is rather unique. The upline will teach its downline the same skills and methods that the former has successfully used. The downline, in turn, will try to follow exactly what the upline has taught them and to imitate upline behavior. In other words, the presumption is that if the follower stays with a successful leader and copies the leader’s way of doing business, then the follower should be successful as well. Because the downline always follows the upline, the issue of leadership therefore becomes a very interesting and important one in the direct selling industry. Does leadership style have any impact on follower performance? If so, what type of leadership style or behavior would be most ideal or appropriate to lead and motivate followers to achieve maximum results?

### **4. Role of Leadership in Direct Selling**

Leadership has always been an important requirement of any organization’s success regardless of the industry to which the organization belongs. Today’s business environment is facing more rapid change than ever before. As our environment becomes more uncertain, good leadership becomes an even more important requirement for organizational success.

Because of the unique nature of the direct selling industry, leaders occupy a special position. Leaders in this industry can be classified into two types: (1) the management team of the direct selling company and (2) independent salespeople’s teams. In direct selling, the leader of the independent salespeople’s team is less important than the leader of the corporate management team. In terms of running the business, the salespeople (or distributors) are independent of the direct selling organization. They are responsible for their own finances as well as their members. Moreover, these salespersons usually work as a team. The recruiter of the team acts like a leader who influences and helps his or her team of followers carry out their work. The team leader is often directly involved in ensuring that his/her team members work well together and are effective and satisfied with their work.

As the direct selling industry becomes increasingly competitive, many direct selling companies are trying to find and develop the best solution for their business. The salesperson (distributor) lies at the hearts of the direct selling business. If there is no distributor, that means there is no revenue for the business. The key difference between direct selling and other industries is the distributor. In the direct selling business, the salesperson (or distributor) is independent from the company. Therefore, defining, measuring and assessing distributor style becomes a critical issue.

## **5. Purpose of Study**

The primary goal of this study is to examine the impact of leadership style on follower (distributor) performance in the direct selling industry. Furthermore, it seeks to examine the impact of a leader-created work environment on follower performance. The specific research objectives can be stated as follows:

1. To study the impact of leadership style on follower's performance and leader outcomes in direct selling.
2. To explore the relationship between leadership style and follower performance and leader outcomes in direct selling.
3. To explore which leadership styles are more effective in influencing performance.
4. To explore the impact of demographic differences on follower performance.

## **6. Significance of Study**

This study is significant from at least three aspects:

- (1) It attempts to examine the impact of leadership on organizational and follower performance. Many studies on leadership to date have not focused on performance variables. Furthermore, the results of studies that have looked at performance have been mixed.
- (2) It represents a pioneering attempt to investigate the impact of leadership on performance in the direct selling industry. Even though there have been many leadership studies, there is no known study on leadership's role and impact in the direct selling industry.
- (3) This study will shed light on leadership styles in the direct selling industry. This industry is growing in importance, especially in Thailand. Despite the importance of leadership in the direct selling industry, there is no known study on this subject. The results from this study will have important implications for leadership training in this industry.

## **7. Leadership Theories**

Research into leadership is very extensive. There have been a lot of assertions and theories about leadership. However, most of these are highly subjective and approach the subject within an unacknowledged cultural framework of values and assumptions. In the past, researchers have attempted to focus on areas such as democratic versus autocratic leadership, participative versus directive decision-making, relationship focus versus task focus, and initiation versus consideration behavior (Bass, 1990). The first phase of leadership theory evolution is known as the "Personality Era" or trait period which focuses on personalities to define the effective leader. Next came the "Behavior Era" which emphasizes two important dimensions of leader behavior: initiating structure (concern for the task) and consideration (concern for relationships). The third phase is the "Contingency Era" which postulates that effective leadership came from one or more factor of behavior, personality, influence and situation. The fourth phase is the "Transactional and Transformational Era" which focuses on leadership behavior during periods of organizational transition and on processes.

In 1973, Downton was the first researcher to distinguish transformational and transactional leadership to account for differences among revolutionary, rebellious, reform, and ordinary leaders. However, Downton's conceptualization did not take hold until Burns's seminal work on political leaders appeared in 1978. Transformational leadership has been observed at all organizational levels in industrial, educational, government, and military settings (Avolio & Yammarino, 2002; Avolio, Bass, & Jung, 1996). Moreover, both transactional and transformational leadership styles have been shown to exist to some degree at all levels of various profit, nonprofit, and military organizations. Many studies have sought to find the relationship between leader behavior and performance or other indicators such as motivation and trust. Some leadership studies have been directed primarily toward such changes as maintenance of quantity or quality of performance, substitution of one goal for another, shift of attention from one action to another, reduction in resistance to particular changes, or implementation of decisions within a contextual framework. Leaders can change this contextual framework to benefit not just the individual but the organization as well.

Kuhner and Lewis (1987) refer to this as a change in the “mean making” system, or in how individuals interpret the challenges set before them in their jobs and careers.

Much literature over the past fifty years has been aimed at identifying and comparing behaviors, traits, characteristics, and reactions of subordinates to certain leadership behaviors in differing work environments. Especially, there is a dearth of research in direct selling. Little if any research has examined the impact of leadership style in this important industry. Sparks (2001) explained the effect of transformational leadership in terms of a higher-order motive in multilevel marketing organization. His finding supports the notion that transformational leadership has a positive relationship with belief in a higher purpose of one’s work and job satisfaction, unit cohesion, and effort.

The relationship between “upline” (sponsors) and “downline” (recruits) is very important in the direct selling industry. An upline is an existing member who persuades a new member or downline to join the organization. This relationship is like a leader–follower relationship. The “upline” is leader and the “downline” is follower. In direct selling, the distributors always work as a team even though they are independent contractors. The informal relationship in working as a group is an importance factor. In direct selling it is believed that if you want to be successful, you must copy and trust your sponsor or upline. Although members operate independently, units provide a tangible organization through which members can create and maintain a sense of belonging, develop a feeling of esprit de corps, and acquire resources helpful to their individual distributorships. Moreover, units serve as a vehicle for socializing members into the norm and values of the MLM and a conduit through which members can mutually reinforce the effects of sponsors’ leadership behaviors (Waldman and Yammarino, 1999; Yammarino and Dubinsky, 1992).

The present study examines the impact of transactional-transformational leadership style on follower performance in the direct selling industry.

## **8. Research Model and Hypotheses**

In the direct selling industry, the distributor usually works in a team but is independent from his team members. The relationship between leader (upline) and follower (downline) in the team is very important. The upline acts like a quasi-leader. Most followers believe that they can be successful if they follow what their leaders do. Therefore, this research will investigate the impact of leadership style on follower performance in the direct selling industry.

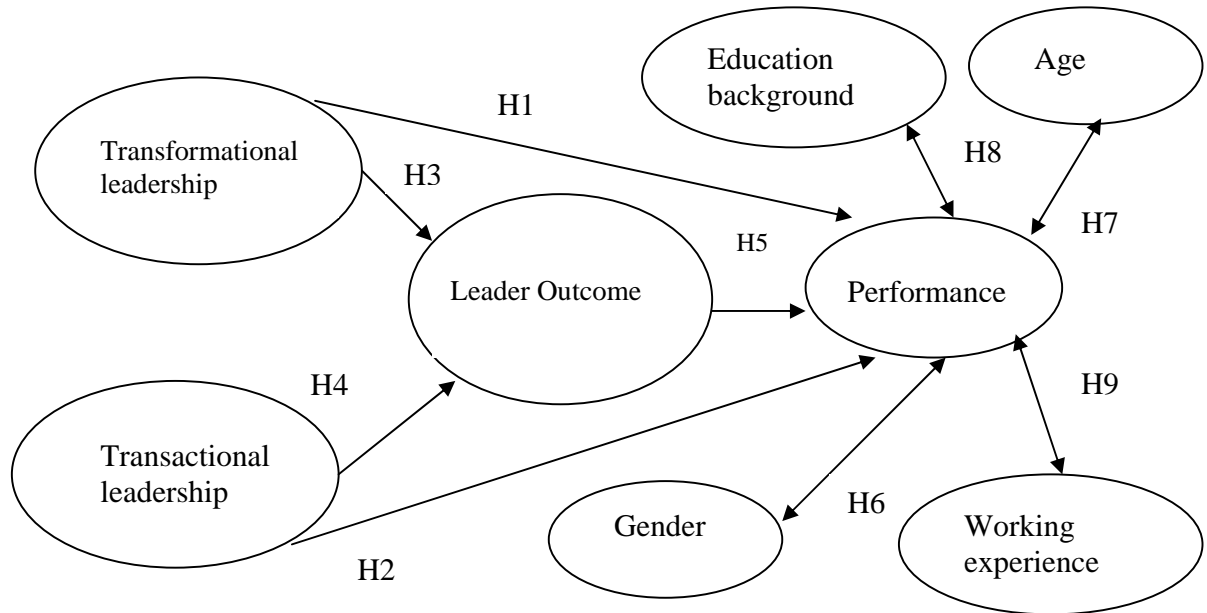
This study adapts the Full Range Leadership theory and its instrumentation (Bass, 1985; Bass and Avolio, 1997). The Full Range Leadership theory distinguishes among three groups of behaviors that the leader might exhibit: transformational, transactional, and laissez-faire behaviors. Due to the unique nature of the direct selling industry, one person can be both leader (upline) and follower (downline) at the same time. In this industry all salespeople and distributors undergo the same type of training at the beginning period.

In this study we will focus on 2 types of leadership styles, namely transformational and transactional leadership. The laissez-faire style is excluded from this study because in the direct selling industry, people who join as newcomers expect to be trained by the upline. Newcomers have to attend leaders seminars put up by the upline. Hence, the laissez-faire style is not appropriate for this study.

The theoretical model guiding this research is presented in **Figure 4**. It shows the relationship between leadership style, leader outcome and performance.

Transformational leadership, as defined by Bass (1990), includes four types of behaviors: (a) charisma (idealized influence or attributes); (b) inspirational motivation; (c) intellectual stimulation, and (d) individual consideration. Transactional leaders display behaviors associated with both constructive and corrective aspects. The constructive behavior style is labeled contingent reward and the corrective style is labeled management-by-exception (active or passive). The term “leader outcome” refers to the leader’s impact on the follower as measured by the follower’s satisfaction with the leader, perceived leader

effectiveness, extra effort put in by follower, cohesion, and performance. **Table 1** summarizes the variables under study.



**Fig. 4 Research Model**

|   |
|---|
| <u>Transformational Leadership</u>      |
| Idealized Attribute (IA)                |
| Idealized Behavior (IB)                 |
| Inspiration Motivation (IM)             |
| Intellectual Stimulation (IS)           |
| Individual Consideration (IC)           |
| <u>Transactional Leadership</u>         |
| Contingent Reward (CR)                  |
| Management by Exception: Active (MBEA)  |
| Management by Exception: Passive (MBEP) |
| <u>Leader Outcomes</u>                  |
| Extra Effort                            |
| Effectiveness                           |
| Satisfaction                            |
| <u>Demographic Variables</u>            |
| Gender                                  |
| Age                                     |
| Educational Background                  |
| Work Experience                         |

**Table 1: Variable Operationalization**

## 9. Impact of Leadership Style on Performance

Accumulated research evidence indicates that transformational leadership has a positive impact on performance (Humphreys and Einstein, 2003). A meta-analysis points to a positive relationship between transformational leader and performance (Bass et al, 2003). In addition, there are studies that indicate that a transactional leadership style is positively related to follower commitment, satisfaction, and performance (Bycio et al, 1995; Podsakoff et al, 1994).

Consequently, the first set of hypotheses is generated to test the direct effect of transformational and transactional leadership on downline (follower) performance. These hypotheses are stated in the null form:

**Hypothesis 1:** Transformational leadership has no effect on downline performance.

**Hypothesis 2:** Transactional leadership has no effect on downline performance.

## 10. Impact of Leadership Style on Leader Outcome

Numerous studies have examined the association between transformational and transactional leadership with outcome variables. Significant relationships have been found between leadership style and outcome among school principal (Sharon, 2003), firefighters (Pillai and Williams, 2004), military personnel (Yammarino and Bass, 1990) and salespeople (Dunbinsky et al, 1995). Most of the studies show a positive relationship between transformational leadership and leader outcome (as defined by perceived leader effectiveness, extra effort, satisfaction with leader). Transactional leadership is found to have weaker relationships to behavior and performance compared to transformational leadership.

In this study, we would like to know whether the relationships found in prior studies will hold in the direct selling business. Hence, the following hypotheses are generated:

**Hypothesis 3:** Transformational leadership has no effect on leader outcome.

**Hypothesis 4:** Transactional leadership has no effect on leader outcome.

## 11. Effect of Leader Outcomes

Prior studies have shown that leader outcomes have an impact on follower performance (Wilson and Frimpong, 2004). However, in order to be consistent with the other hypotheses, we will state this hypothesis in the null form:

**Hypothesis 5:** Leader outcomes have no effect on follower performance.

## 12. Effect of Demographic Variables

Virtually everyone can participate in the direct selling business. The successful salesperson does not need to meet any criteria or to have a certain type of background or experience. It would therefore be interesting to see whether or not there is any relationship between individual demographic variables and performance. Furthermore, recent trends have shown that network marketing, or direct selling, is a rapidly growing segment of the sales industry, and one in which women are particularly successful (Lawrynuik, 2002). Hence, it would be interesting to see whether or not there is a difference between gender and performance.

**Hypothesis 6:** There is no difference between genders as related to follower performance.

Hypothesis 6.1: There is no difference in commission between male and female.

Hypothesis 6.2: There is no difference in number of followers between male and female leaders.

Hypothesis 6.3: There is no difference in number of new members in terms of gender.

Another important demographic variable is the age of the salesperson. In this study, we seek to explore whether or not age has any thing to do with follower performance.



**Hypothesis 7:** There is no difference in age as related to follower performance.  
Hypothesis 7.1: There is no difference in commission as related to age.  
Hypothesis 7.2: There is no difference in number of followers in relation to age.  
Hypothesis 7.3: There is no difference in number of new members in relation to age.

Based on the author's own industry experience, salespeople who graduated with a university degree tend to exhibit better performance than those who graduated only from high school. Therefore, this study also explores the relationship between educational background and follower performance.

**Hypothesis 8:** There is no difference in educational background as related to follower performance.  
Hypothesis 8.1: There is no difference in commission as related to educational background.  
Hypothesis 8.2: There is no difference in number of followers in relation to educational background.  
Hypothesis 8.3: There is no difference in number of new members in relation to educational background.

A final demographic variable to be examined is the experience of the salesperson. One would think that more experienced salespeople should be more successful. However, based on the author's observations, this is not necessarily true in all cases. Some new distributors actually outperform the experienced ones. Hence, we predict that there is no difference in work experience among successful and satisfied followers.

**Hypothesis 9:** There is no difference in work experience as related to follower performance.  
Hypothesis 9.1: There is no difference in commission as related to work experience.  
Hypothesis 9.2: There is no difference in the number of followers in relation to work experience.  
Hypothesis 9.3: There is no difference in the number of new members in relation to work experience.

### 13. Methodology

This study employs a survey research design based on the highly popular Multifactor Leadership Questionnaire (MLQ). MLQ measures a broad range of leadership types from passive leaders, to leaders who give contingent rewards to followers, to leaders who transform their followers into becoming leaders themselves. It was developed by Bernard Bass and his associates to determine the degree to which leaders exhibited transformational and transactional leadership and the degree to which their followers were satisfied with their leader and their leader's effectiveness.

The survey instrument used in this research consists of 55 questions. It is divided into three parts. Part 1 contains the 45 items of MLQ-5X developed by Avolio and Bass (1995) – these 45 items are broken down into 20 items of transformational leadership, 12 items of transactional leadership, 4 items of laissez-faire leadership and 9 items of outcome of leadership. Part 2 of the survey contains 3 items of "unit cohesion" developed by Podsakoff and MacKenzie (1994). Part 3 consists of 7 items pertaining to demographic variables.

Data were collected by mail survey. Respondents were distributors or independent salespeople working with one of 200 direct selling organizations throughout Thailand. These organizations had to register with the appropriate government agency (Consumer Protection) in order to avoid being labeled as a "pyramid" company. These companies were located mainly in the capital city of Bangkok and its surrounding metropolitan areas. The names of 1,000 distributors (respondents) were randomly obtained from these 200 companies. Of the 1,000 questionnaires mailed out, 328 were returned, thereby giving a 32.8% response rate. However, 28 of the questionnaires were unusable due to missing data; therefore the final sample size was 300. After all the questionnaires were collected, the score of each leadership style and leader outcome factor was calculated. Thereafter, we calculated the average score of the factor by adding up the scores on the questions and dividing the sum by the number of questions.

To test the relationships between leadership and leader outcome, path analysis was used to explore the cause-and-effect between leadership style and leader outcome. This technique was also used to test the cause-and-effect relationship between leadership style and follower performance. Hence, path analysis was used to test Hypotheses 1 through 5. The statistical program selected for doing path analysis was AMOS version 3.6 (Arbuckle & Wothke, 1999).

To test the relationships between demographic variables and follower performance, we use a combination of t-tests and ANOVA. To explore the relationship between gender and follower performance, t-test was employed. This technique was also used to test the relationship between leader outcome and performance. One-way ANOVA was used to explore the relationships between age, education background, work experience and follower performance.

## **14. Results**

Perhaps the most interesting finding was that both transformational and transactional leadership styles had no impact on downline (follower) performance. Hence, both H1 and H2 were supported. However, unlike the case of transformational leadership, the results show that transactional leadership actually had a negative impact on follower performance. On the other hand, the results show that both types of leadership styles had a positive impact on leader outcomes. Hence, H3 and H4 were supported. The findings also reveal that leader outcomes had a strong positive impact on follower performance. Hence, H5 was supported.

In relation to the demographic variables, the results are as follows:

1. Gender made a difference in all areas of follower performance (H6a-c were rejected);
2. Age made a difference in terms of commission and number of new members but not number of followers (H7a & H7c were rejected but H7b was supported);
3. Educational background made a difference in terms of commission and number of followers but not number of new members (H8a & H8b were rejected but H8c was supported);
4. Work experience made a difference in all areas of follower performance (H9a-c were rejected).

## **15. Conclusion and Implications**

This research is significant in that it is the first attempt to propose a valid instrument to measure leadership styles in the direct selling industry. Furthermore, it explains the impact of leadership style on follower performance. The following discussion summarizes some managerial insights and implications derived from the research findings:

1. The results of this study show that leadership style affects both follower performance and leader outcome, but leader outcome also affects follower performance. If we read these results together with the saying “follow your leader’s behavior, then you will succeed”, it implies that follower performance does not depend solely on leadership style - follower performance also depends on leader outcomes. If the follower is satisfied with the leader, then the follower’s performance will be better. Therefore, the company and top distributor should consider this point. If the follower copies the leader’s style, the leader may not be successful because his follower is not satisfied with him.
2. The finding that transformational leadership has no effect on follower performance and that transactional leadership has a negative effect on follower performance should be of concern to any direct selling management team. The direct selling business is unique: the salespeople/distributors are independent from their company, meaning that they will not have any corporate financial support and will have to rely on themselves for their performance. Therefore, motivation is more important than reward or punishment from the leader. It implies that if the

- leader exchanges something with the follower when the latter did well or worse, it can't inspire the follower to achieve the goal. On the other hand, the leader who tries to motivate the follower is not guaranteed better performance from the follower. The success of the leader does not mean the success of his followers.
3. The results show a significant impact of leader outcomes on follower performance. This implies that follower perception is more important than leader behavior. If the follower trusts and perceives his leader in a good way, the performance will be better. Therefore, the management team should be careful when making important decisions and may want to consider an indirect approach to solving problems.
  4. The direct selling business gives everyone a chance to join. It has no requirement or criteria for admission. Distributors and salespeople come from all walks of life. The differences in gender, age, educational background, and work experience may make a difference in performance. The leader should therefore be concerned about this difference when he recruits a new member or gives any suggestion to his followers. If the leader does not understand the differences in performance related to gender, age, educational background, and work experience, he may not understand the follower's mind and may cause the follower to be disappointed as a result. In direct selling, if the follower is not satisfied with the leader, he or she will switch to another team or move to another direct selling company. Changing or moving to another team or organization means loss in revenue.
  5. The results of this study bear important implications for the training programs of any direct selling company. Direct selling training programs can generally be divided into two categories: (1) product training and (2) leadership or sales training. Presently, most direct selling companies in Thailand focus on the product and the relationship between distributor and customer or the sponsoring process. Corporate staff generally provides training on how to demonstrate a product, how to open the mind of a new member, how to motivate a new member, and so forth. However, there are no courses that teach how the leader (upline) should act in order to satisfy the follower. Hopefully, this study will alert direct selling companies to revamp their training programs.

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