



Referral marketing: Harnessing the power of your customers



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Abstract The differences between traditional and referral marketing programs are so great that the two share little overlap in terms of appropriate target markets, marketing objectives, marketing organization, and overall planning and implementation strategies. Traditional marketing programs seek advocates among current employees to spread word of mouth, aim marketing efforts at high lifetime-value customers, focus on customer satisfaction, and use promotional programs that heavily rely on social media. In contrast, referral marketing relies on motivating satisfied/delighted customers as a referral base, seeking current customers that can provide referrals with a high lifetime value, using referral-based marketing programs to augment traditional promotions, and developing a compensation system for referrals based on either direct payment or increased visibility. Major advantages of referral marketing programs as compared with traditional marketing programs include greater credibility of friend/family member recommendations over paid advertisements, access to new customers that traditional marketing programs may not reach, and better matching of referred customers' needs to a good or service. This article presents an eight-step process to develop, implement, and evaluate the success of a referral program. In addition, it discusses academic research findings and presents examples of successful referral program strategies from—among others—Dropbox, Roku, PayPal, Digitalis, and Omaha Steaks.

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1. Getting to know customer referral programs

Customer referral programs are marketer-directed, word-of-mouth initiatives that entice existing customers to attract friends, family members,

and business contacts to become new customers (Kumar, Petersen, & Leone, 2010). Unlike pure word-of-mouth programs, which are customer initiated, referral programs are marketer directed. Marketers often prefer using customer referral programs as opposed to pure word of mouth due to the ability to use incentives to stimulate referrals and to have greater control over message content.

A classic referral marketing success story involves Dropbox, a file sharing synchronization and storage

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provider that expanded its customer base from 100,000 to 4 million users in a 15-month period. Dropbox used a simple referral reward system, giving 500MB increases in storage to both the referrer and the referred party when the latter signed up for any level of service. Dropbox's CEO, Drew Houston, calculated the cost of acquiring this large customer base at \$10 billion had traditional marketing programs instead been used. Other media were also not appropriate for Dropbox due to high costs. For example, Dropbox estimated the cost of acquiring customers using Google's AdWords at between \$233 and \$388 per individual; this was too expensive for a service that charges clients as little as \$9.99 per month (Veerasamy, 2014).

There are two types of referral programs: one in which existing customers are paid an incentive, and another in which current customers work without pay on presentations, case histories, and user forums. The second program benefits the referrer by increasing visibility, heightening his or her recognition as a specialist, and/or gaining special treatment from a supplier/vendor (Lee, 2012b). Both program types share common characteristics. They are initiated, managed, and at least partially controlled by the marketer. They use the social connections of existing customers with their friends, family, and business associates. They focus a firm's marketing efforts on existing customers as opposed to new customers. And, finally, the referring customer receives an incentive in each program type, either via direct or indirect payments. Direct payments can come in several forms, such as cash, points in a loyalty program, miles, free goods and services, or donations to a nonprofit organization in the name of the recommending party. In the indirect payment type, the referrer may receive recognition as an expert or may be given the opportunity to serve on a company advisory board (Schmitt, Skiera, & Van den Bulte, 2011).

Referral marketing programs are used by a large number and a wide variety of firms. A recent search on Bing for 'recommend-a-friend program' yielded over 19 million hits. A Google search using the keywords 'member-get-member-campaign' yielded almost 357 million results. Direct payment referral programs have been used by American Express, Marriott, DirecTV, Time Warner, Netflix, AT&T Wireless, AAA, Virgin Mobile, Verizon Wireless, Omaha Steaks, Vonage, Scottrade, and 24 Hour Fitness. Similarly, formal indirect payment referral programs exist in a wide variety of companies and industries, including SAS Institute (Canada), 3M, and Microsoft.

Many referral programs involve services, since personal referrals work especially well for experience goods like telecommunications services or gym

club memberships (Barrot, Becker, & Meyners, 2013). Referral programs are also particularly suitable for firms that sell high-risk goods and services (e.g., those that cannot be used on a trial basis or that have high safety or performance risk), for small firms with limited marketing budgets, and for niche markets where traditional promotions cannot effectively reach the target audience. The use of referral marketing programs should increase significantly due to the heightened popularity of social media, the greater use of customer databases by firms, and the growing number of firms available to outsource referral programs.

Despite the widespread use of referral marketing, few studies have examined the value of word of mouth on referral behavior or how referral-based information can be used to more effectively secure new customers (Kumar et al., 2010). There has also been little academic research on when referral rewards should be used or the optimal design of referral programs (Xiao, Tang, & Wirtz, 2011). Misner (1999) describes word-of-mouth marketing as the world's most effective, yet least understood marketing strategy.

This article highlights for marketers the differences between traditional and referral marketing programs and the advantages and disadvantages of referral marketing versus traditional marketing programs. In addition, it develops an action-based plan for planning, implementing, and evaluating referral programs by incorporating both research findings and best marketing practices.

1.1. Differences between traditional and referral marketing programs

The differences between traditional and referral marketing programs are so great that there is little overlap between the programs in terms of appropriate target markets, marketing objectives, marketing organization, and overall planning and implementation strategies. Traditional marketing programs seek advocates among current employees to spread word of mouth, aim marketing efforts at high lifetime-value customers, and use customer loyalty programs to instill buying among current customers through rewards. In contrast, referral marketing relies on motivating current customers as a referral base, views customers as influencers and advocates, seeks out current customers that can provide referrals with high lifetime value, and uses referral-based marketing programs to augment traditional promotions. According to Bill Lee (2013), a referral marketing consultant: "The organizations that achieve rapid growth are those that don't just think of customers as 'buyers of stuff' but as advocates, influencers, and

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